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NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

THESIS

**SANCTIONING SUCCESS?
ASSESSING THE ROLE OF SANCTIONS IN THE
MILITARIZATION OF IRAN**

by

Richard L. McKnight II

December 2010

Thesis Advisor:
Second Reader:

Robert Looney
James Russell

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**SANCTIONING SUCCESS?
ASSESSING THE ROLE OF SANCTIONS IN THE MILITARIZATION OF IRAN**

Richard L. McKnight, II
Lieutenant, United States Navy
B.S., United States Naval Academy, 2002

Submitted in partial fulfillment of the
requirements for the degree of

**MASTER OF ARTS IN SECURITY STUDIES
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from the

**NAVAL POSTGRADUATE SCHOOL
December 2010**

Author: Richard L. McKnight II

Approved by: Dr. Robert E. Looney
Thesis Advisor

Dr. James Russell
Second Reader

Dr. Harold A. Trinkunas
Chairman, Department of National Security Affairs

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ABSTRACT

In its three decade history, the *Sepah-e Pasdaran-e Englab Eslami*, or Islamic Revolutionary Guards Corps, evolved from the relatively modest role of ad hoc security apparatus into its current state as an independent and professional, armed force enmeshed in the political and economic life of modern Iran. In tracing the history of the Guards, one cannot help but take note of how multiple rounds of U.S. sanctions have set the stage for this transformation. Sanctions imposed under the Carter and Reagan administrations created a defense gap by first severing ties between the Iranian and U.S. defense industries and then choking the flow of U.S. war materiel through intermediaries. The Guards, buoyed by their connection to Iranian defense conglomerate DIO, rose with the tide of domestic wartime spending; emerging from the Iran-Iraq War with a considerable construction and manufacturing base. The Guards were then able to leverage this base to dominate postwar reconstruction in Iran, spurred by a gap in foreign development activity exacerbated by the Clinton era sanctions. Today, smart sanctions appear to continue this trend by the creation of a finance gap that is tilting the ongoing privatization of Iran's burgeoning public sector squarely in favor of the Guards.

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LIST OF ACRONYMS AND ABBREVIATIONS

| | |
|-------|--|
| CISAD | Comprehensive Iran Sanctions, Accountability, and Divestment |
| DIO | Defense Industries Organization |
| E. O. | Executive Order |
| FIPPA | <i>Foreign Investment Promotion and Protection Act</i> |
| GDP | Gross Domestic Product |
| HEU | Highly Enriched Uranium |
| H. R. | House Resolution |
| IAEA | International Atomic Energy Agency |
| IEEPA | International Emergency Economic Powers Act |
| ILSA | Iran-Libya Sanctions Act |
| IPO | <i>Iranian Privatization Organization</i> |
| IRGC | Islamic Revolutionary Guards Corps |
| ISA | Iran Sanctions Act |
| MIO | Military Industries Organization |
| NICIC | National Iranian Copper Industries Company |
| NIOC | National Iranian Oil Company |
| OEF | Operation Enduring Freedom |
| OIF | Operation Iraqi Freedom |
| P. L. | Public Law |
| TCI | Telecommunications Company of Iran |
| UAE | United Arab Emirates |
| U.S. | United States |
| USD | United States Dollars |
| WMD | Weapons of Mass Destruction |
| WTO | World Trade Organization |

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I. THESIS INTRODUCTION

A. MAJOR RESEARCH QUESTION

The scope of the Islamic Revolutionary Guards Corps, *Pasdaran*, in Iranian political, social, and economic life has undergone periods of stagnation and rapid expansion since the organization's inception in 1979.¹ The focus of this thesis is unraveling the role of sanctions in shifting the balance of power between the *Pasdaran* and the traditional source of power in the Iranian theocracy the Iranian clergy, or *ulama*. To adequately explore this issue requires charting the history of the IRGC and identifying pertinent social, political, and economic factors that contributed to an increase in power.

The purpose of this thesis is to determine whether the imposition of sanctions has created more fertile domestic economic conditions that could later be exploited by the IRGC. If the linkage between sanctions and economic opportunity can be substantiated, then the case must be made that the broadening of the *Pasdaran's* economic base has translated into political power gains within the Iranian regime. In addition to economic conditions, this thesis may explore whether the imposition of sanctions has created social or political conditions in Iran, which favors militarization.

B. JUSTIFICATION

The Islamic Republic of Iran presents significant opportunities and challenges for the United States due to its status as a key regional actor within the Middle East and an important global supplier of natural resources. The considerable size of the Iranian state, population, and security forces combined with the geostrategic significance of the Iranian coastline (Persian Gulf and Straits of Hormuz) elevate Iran to the top of the list of powerful and potentially disruptive regional actors. This disruptive potential is exacerbated by the unique political character of the Islamic Republic. Iran's role as a

¹ For purposes of disambiguation, contemporary sources refer to the Islamic Revolutionary Guard Corps as the *Pasdaran*, or *Sepah-e Pasdaran-e Enghlab Eslami*, the Guards, or the Corps; they will be referred to hereafter as the *Pasdaran*, IRGC or the Guards.

Shi'a-ruled, Persian pariah and constitutionally-mandated exporter of Islamic revolutionary sentiment complicates relationships between Iran and its secular and/or monarchical neighbors.² Of particular regional interest to the United States is the history of Iranian interference in both the Iraqi (OIF) and Afghan (OEF) theaters of operations and Iran's continuing role as a state sponsor of terrorist organizations (the Quds Force (a branch of the IRGC), Hezbollah, and Hamas).³

In addition to exerting considerable regional influence, Iran remains an important trading partner to many countries due to its considerable natural resource endowments. An abundance of hydrocarbon resources, in particular, ensures that the Islamic Republic will remain an indispensable supplier to world energy markets. Iran is the second largest producer of crude oil in the Organization of Petroleum Exporting Countries and ranks third in the world in terms of proven oil reserves (second barring Canadian unconventional oil sources) and second in the world for natural gas reserves.⁴

The indelible presence of Iran in regional and global security matters makes understanding the ramifications of U.S. foreign policy vis-à-vis Iran an issue of particular interest to the United States. To reach an understanding of U.S.-Iranian relations necessitates an understanding of the effects of sanctions. A brief overview of the 31 year history between the two states reveals that unilateral and multilateral sanctions against the government of Iran is the preferred response to Iranian aggression and defiance of U.S. and allied regional interests. Between President Carter's opening volley, Executive

² Irano-British Chamber of Commerce, *The Constitution of the Islamic Republic of Iran*, March 1, 2004, Article 2, <http://www.ibchamber.org/lawreg/constitution.htm> (accessed July 7, 2010).

³ Office of the Coordinator for Counterterrorism, "Country Reports on Terrorism 2008-Chapter 3: State Sponsors of Terrorism," U.S. Department of State, April 30, 2009, <http://www.state.gov/s/ct/rls/crt/2008/122436.htm> (accessed July 20, 2010).

⁴ CIA World Fact Book, *Country Comparisons: Oil - Proved Reserves*, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2178rank.html> 01 January, 2010. (accessed 14 July, 2010); U.S. Energy Information Administration (EIA), *Country Analysis Brief: Iran: Natural Gas*, <http://www.eia.doe.gov/cabs/Iran/NaturalGas.html>, January 2010. (accessed 14 July, 2010).

Order 12170, on November 14, 1979 and the broadening of U.S. sanctions in response to UNSCR 1929 on June 9, 2010, the United States amassed a ledger of over 40 sanctions-related laws and regulations.⁵

The heavy reliance on political and economic sanctions as a tool of American diplomacy demands a greater understanding of the peripheral effects. Included in this group of these effects is the relationship between these sanctions and the gradual militarization of the Iranian government. Therefore, a clear understanding of this relationship is necessary to accurately represent the tradeoffs associated with the pursuit of a particular policy and to more precisely determine the calculus of U.S.-Iranian foreign policy.

In summary, this thesis warrants examination due to both the importance of the subject and the prevalence of the focus. Iran is a country at the nexus of Middle Eastern and global relationships and intrigues. This approach to studying Iran, the role of sanctions in the militarization of Iran, addresses a diplomatic issue that is both relevant, given the sheer volume of sanctions introduced over the last three decades, and contemporary, given the current round of sanctions being discussed and implemented as of the writing of this thesis.

C. PROBLEMS AND HYPOTHESES

The factious circles of formal and informal power within the Islamic Republic of Iran make information a tightly-controlled commodity. The primary obstacle in preparing this thesis was penetrating the veil of opacity that shrouds IRGC operations and, more generally, the social, economic, and political life of Iran. Accepting North Korea, few countries represent a greater challenge than Iran for gathering accurate political, social, and economic data. Addressing this problem required tracing the

⁵ Jimmy Carter, "Executive Order 12170 Blocking Iranian Government Property," The [U.S.] National Archives: The Federal Register, <http://www.archives.gov/federal-register/codification/executive-order/12170.html> (accessed July 20, 2010); UN News Centre, "Citing Iran's failure to clarify nuclear ambitions, UN imposes additional sanctions," United Nations News Centre, June 9, 2010, <http://www.un.org/apps/news/story.asp?NewsID=34970&Cr=iran&Cr1> (accessed July 6, 2010); United States Department of the Treasury, *Office of Foreign Asset Control: Iran Sanctions*, June 16, 2010, <http://www.treas.gov/offices/enforcement/ofac/programs/iran/iran.shtml> (accessed July 07, 2010).

activities of organizations later tied to the IRGC, assembling myriad sources that only touch the thesis subject tangentially, and incorporating some speculative assertions from Iranian insiders.

The material gathered to produce this thesis points toward a linkage between the levying of sanctions and the expansion of the IRGC into the Iranian economy. This thesis will attempt to show that sanctions have created a unique set of social, political, and economic conditions within Iran and that these conditions favor the success of the IRGC over its domestic and foreign competitors. The mechanisms for the creation of these conditions are included in the following hypotheses.

1. HYPOTHESIS #1 Sanctions Created a Military-Industrial Gap in Iran on What the IRGC Would Capitalize

One of the potential mechanisms responsible for contributing to the success of the IRGC over its nonstate competitors is an early connection to the Iranian military industrial complex. Sanctions prohibiting the sale of arms to Iran diverted Iranian wartime spending away from its previous outfitter, American and British defense manufacturers, in favor of the construction of a domestic manufacturing infrastructure.

2. HYPOTHESIS #2 Sanctions Allow IRGC to Capitalize on Identity as Guardians of Islamic Revolution

Another hypothesis explored in this thesis is that sanctions strengthened the ideological divide between Iran and the United States. Any punitive action taken by the United States against the Islamic Republic can be presented to the Iranian domestic audience as an attack against Iranian theocracy or more broadly as an attack against Islam. Understanding that while the citizens of Iran may hold conflicting views on the

individual powerbrokers in the Iranian government, polling results show that the majority of Iranian citizens still approve of their system of government.⁶

3. HYPOTHESIS #3 Sanction Effects on Private Enterprise Are Greater Than Sanction Effects on IRGC

One of the potential mechanisms responsible for contributing to the success of the IRGC over its nonstate competitors is that the sanctions regimes placed a disproportionate economic pressure on Iranian private enterprise by limiting access to industrial inputs. The IRGC, through its relationship with the government and its role in the provision of internal security, is able to alleviate some of these negative effects of these sanctions.⁷ As sanctions constrain the legitimate channels for goods and materials flow of goods and materials into the Iran, businesses aligned with the IRGC have access to smuggling channels that is unparalleled by their competitors in the private sector.⁸

4. HYPOTHESIS #4 Sanctions Increase Risk Exposure That Inhibits Foreign Competition

The final hypothesis on the effect of sanctions on Iranian militarization is that the increasing employment of targeted sanctions against businesses and individuals involved in Iran raised the economic and political risks associated with doing business in Iran.⁹ Elevating risks discourages more risk-averse American, European, and Asian companies

⁶ Stephen Kull, "Is Iran Pre-revolutionary?," *World Public Opinion.org.*, November 23, 2009. <http://www.worldpublicopinion.org/pipa/articles/brmiddleeastnafricara/651.php?lb=brme&pnt=651&nid=&id=> (accessed August 15, 2010). and Kull, Stephen, Clay Ramsay, Stephen Weber, and Evan Lewis. "An Analysis of Multiple Polls of the Iranian Public." *World Public Opinion.org.*, February 3, 2010, http://www.worldpublicopinion.org/pipa/pdf/feb10/IranElection_Feb10_rpt.pdf (accessed August 15, 2010).

⁷ The concept of IRGC monopoly in smuggling goods is discussed briefly in the article: *The Economist*, "International: Showing Who's Boss: Iran's Revolutionary Gurads," *The Economist*, August 29, 2009.

⁸ The role of the IRGC and UAE in smuggling goods into Iran is discussed in the article in the *Economist*. "Sanctions on Iran: Anything to Declare?" *The Economist*. July 1, 2010. <http://www.economist.com/node/16483587> (accessed July 11, 2010).

⁹ The concept of risk elevation and its effect on Iranian trade is introduced in: Jafari, Omeed. "IRGC, Inc.," AEI: American Enterprise Institute for Public Policy Research, May 17, 2007, <http://www.aei.org/article/26194> (accessed July 11, 2010).

from competing for lucrative construction and engineering contracts.¹⁰ Limitation and elimination of foreign competition from the Iranian economy shifts the demand to fulfill these contracts inward. In turn, the IRGC is ideally positioned to capture the domestic market through leverage of its network of businesses including the Khatam-ol-Anbia, or Ghorb, the *Pasdaran* equivalent to the U.S. Army Corps of Engineers.¹¹

D. LITERATURE REVIEW

The study of Iran, in general, is experiencing a resurgence of attention as of the writing of this proposal. Controversy surrounding the 2009 re-election of Iranian President Mahmoud Ahmadinejad, the emergence of a grassroots opposition movement, and the ongoing nuclear crisis have all thrust the Islamic Republic back into the international spotlight. Hence, the focus of this new body of literature is directed primarily toward the more recent expansion of the *Pasdaran* power base under Ahmadinejad or toward a broader discussion of the efficacy of sanctions with respect to the achievement of political goals, specifically discouraging the Iranian nuclear program.¹² Narrowing the focus of research to the expansion of the *Pasdaran* after the 2005 Iranian elections offers an expedient solution due to the number of high profile engineering contracts awarded to IRGC affiliates (Phases 15 & 16 of development for South Pars gas field, Tehran Metro contract, hydroelectric dam tenders in West

¹⁰ The following articles explore the notion that sanctions are stifling foreign competition in the Iranian economy. Will Hadfield, "Privatisation Plan Stalls" [cover story], *MEED: Middle East Economic Digest*, November 2, 2007: 5; Der Spiegel. "German Businesses Gradually Withdrawing From Iran," *Der Spiegel-International*, June 11, 2010, https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/EUP20100614072001#index=1&searchKey=360002&rpp=10 (accessed July 14, 2010); Ralf Beste, Christoph Pauly, and Christian Reiermann, "Twisting Arms: U.S. Pressures Germany to Cut Iran Business Ties," *Der Spiegel Online: International*, July 30, 2007, <http://www.spiegel.de/international/business/0,1518,497319,00.html> (accessed July 26, 2010); Open Source Center. "Highlights: Iran Economic Sanctions, Government Corruption 13–19 Sep 07," *Open Source Center*, September 19, 2007, https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/IAP20070924306002 (accessed July 14, 2010). and Mark Dubowitz, "Argument: The Sanctions on Iran Are Working," *Foreign Policy*, February 10, 2010.

¹¹ Jafari, "IRGC, Inc."

¹² For a good overview of nuclear sanctions see: Brenden Taylor, *Sanctions as Grand Strategy*. London: Routledge, 2010: 60–100 and UN News Centre, "Citing Iran's Failure to Clarify Nuclear Ambitions."

Azarbaijan, Kordestan, Kermanshah, Ilam, Lorestan, and Khuzestan) and the large number of new government appointees with a strong association to IRGC.¹³ However, the *Pasdaran* did not spring into existence in 2005, readymade to shape the Iranian political-economy. Understanding the role sanctions in the militarization of Iran requires understanding the events and relationships that led up to the current explosion of IRGC influence.

The roots of the Islamic Revolutionary Guards Corps trace all the way back to the 1979 Revolution. The newly established regime recognized the contribution of the IRGC in achieving the overthrow of the Pahlavi dynasty and the subsequent establishment of the new Iranian Constitution (adopted October 24, 1979). Article 150 formally enshrined the distinction between the role of the Islamic Revolutionary Guards Corps from the roles of the other Iranian security forces [the regular military (Artesh) and the Law Enforcement Force (LEF)].

*Article 150: The Islamic Revolution Guards Corps, organized in the early days of the triumph of the Revolution, is to be maintained so that it may continue in its role of guarding the Revolution and its achievements. The scope of the duties of this Corps, and its areas of responsibility, in relation to the duties and areas of responsibility of the other armed forces, are to be determined by law, with emphasis on brotherly cooperation and harmony among them.*¹⁴

The ousting of U.S.-friendly monarch, Mohammad Reza Shah Pahlavi, generated animosity at the outset between the United States and Iran's fledgling provisional government. Friction came to a head on November 4, 1979 when a group of students calling themselves the *Muslim Student Followers of the Imam's Line* stormed the

¹³ High-profile IRGC contracts are discussed at length in many of the references cited but are most comprehensively represented in the fifth chapter of: Fredric Wehrey, Jerrold D. Green, Brian Nichiporuk, Alireza Nader, Lydia Hansell, Rasool Nafisi, and S. R. Bohandy, *The Rise of the Pasdaran: Assessing the Domestic Roles of Iran's Islamic Revolutionary Guards Corps* (Santa Monica, CA: RAND Corporation, 2009); IRGC political expansion in the 2000s is summarized in: David E. Thaler, Alireza Nader, Shahram Chubin, Jerrold D. Green, Charlotte Lynch, and Frederic Wehrey, *Mullahs, Guards, and Bonyads* (Santa Monica, CA: RAND Corporation, 2010), 58–64.

¹⁴ Irano-British Chamber of Commerce, *The Constitution of the Islamic Republic of Iran*.

American Embassy in Tehran, taking 63 hostages.¹⁵ President Carter responded in the six months that followed the takeover by issuing three punitive Executive Orders against Iran; 12170, 12205, and 12211. These sanctions effectively froze all Iranian assets within the United States and restricted practically every nonhumanitarian aid-based transaction between U.S. and Iranian actors.¹⁶ These initial rounds of sanctions worked in concert with the anti-West rhetoric emanating from the leadership of the new Islamic regime to draw a line between Iran and a large percentage of the industrialized world. This new paradigm of isolation from the West shifted the focus of the economic activity away from the programs of modernization and integration into global manufacturing chains developed during the Pahlavi dynasty and toward an agenda of industrial self-reliance.¹⁷

The United States enacted the next iteration of sanctions in the midst of the Iran-Iraq War. The writing of the Supreme Leader of Iran Ayatollah Khomeini suggests the embargo against Iran as the impetus for this transition from dependence on foreign manufacturing.

Those of us who seemed to be unable to make or repair anything after the economic blockade was forced on us were impelled to use our minds and brains and succeeded in manufacturing a good many things-that met the needs of the army and the manufacturing plants.¹⁸

Conversely, with regard to Iranian defense manufacturing in the late 1970s and early 1980s, A.T. Shulz comments, “For the indefinite future, Iran’s arms production will

¹⁵ Jimmy Carter Library & Museum. “The Hostages and The Casualties.” Jimmy Carter Library & Museum. July 5, 2005. http://www.jimmycarterlibrary.gov/documents/list_of_hostages.phtml (accessed July 28, 2010).

¹⁶ All relevant Executive Orders can be found at: United States Department of the Treasury. *Office of Foreign Asset Control: Iran Sanctions*. For the convenience of the reader, a comprehensive overview of all U.S.-Iranian sanctions legislation will be included as an appendix in the thesis.

¹⁷ Mohsen M. Milani, *The Making of Iran's Islamic Revolution* (Boulder, CO: Westview Press, Inc., 1988), 105–129.

¹⁸ Ruhullah Khomeini, “IRNA The Last Message: The Political and Divine Will of His Holiness Imam Khomeini (S.A) Last Will and Testament of Imam Khomeini” [translated from Farsi]. <http://server32.irna.com/occasion/ertehal/english/will/lmnew6.htm> (accessed July 19, 2010).

continue to depend on foreign support far more than on domestic policy.”¹⁹ Regardless of the degree of success the republic enjoyed in extricating Iranian defense from its dependency on foreign sources, during the Iran-Iraq War the government directed a large flow of money towards the defense manufacturing sector as wartime defense spending jumped to nearly 17 percent of Iranian GDP.²⁰

An early linkage between the *Pasdaran* and the Iranian defense industry set the stage for self-sufficiency and expansion into the economy.²¹ Gains made in the *Pasdaran* manufacturing base during the war enabled the Guards to answer the call after the last shots were fired to openly enter into the Iranian economy. Many Iranian analysts point to this period as the watershed moment for the coming of age of the IRGC.²²

In the late 1980s and early 1990s, the name of the game in Iran was reconstruction. Eight years of hostilities left infrastructure in the key energy sector in disarray and subsequent hydrocarbon revenues at an all-time low (despite record high oil prices).²³ Compounding the issue, veterans from the Iran-Iraq War returned from the front lines to a bleak economic scene complete with an unemployment rate that had not retreated substantially from the 1987 peak of nearly 50 percent.²⁴ The government’s solution to absorb labor excess and prompt reconstruction efforts was to expand the role of government institutions into the economy.²⁵ The most significant *Pasdaran* response to this invitation was the foundation of the engineering headquarters *Gharargah Sazandegi Khatam al-Anbia*, more commonly known by its abbreviation Ghorb or

¹⁹ A. T. Schulz, “Iran: An Enclave Arms Industry,” in *Arms Production in the Third World*, eds. Michael Brzoska, and Thomas Ohlson, 147–59 (Philadelphia: Taylor & Francis, 1986), 159.

²⁰ R. Verma, E. Wilson, and M. Pahlavani, “The Role of Capital Formation and Saving in Promoting Economic Growth in Iran,” *The Middle East Business and Economic Review*, June 2007: 10.

²¹ Ali Alfoneh, “How Intertwined Are the Revolutionary Guards in Iran’s Economy,” *American Enterprise Institute for Public Policy Research*, October 2007, <http://www.aei.org/outlook/26991> (accessed July 20, 2010): 3.

²² Alfoneh, “How Intertwined Are the Revolutionary Guards in Iran’s Economy.”

²³ Ervand Abrahamian, *A History of Modern Iran* (New York: Cambridge University Press, 2008), 175.

²⁴ Efraim Karsh, *Essential Histories: The Iran-Iraq War 1980–1988* (Oxford: Osprey Publishing, 2002), 86.

²⁵ Wehrey et al., *The Rise of the Pasdaran*, 57.

truncated form Khatam al-Anbia.²⁶ Ghorb has since grown over two decades into the one of the largest entities operating in the domestic Iranian economy.²⁷

As President Rafsanjani and his reformers opened the doors to the Iranian economy to state institutions, the United States launched an effort to close those doors; first to American investment and then to the rest of the industrialized world. In 1995, the Clinton Administration sought to curb Iranian interest in weapons of mass destruction (WMD) by issuing two Executive Orders. E.O. 12957 and 12959 banned, respectively, U.S. investment in the Iranian energy sector and U.S. trade and investment in Iran.²⁸ The following year, the U.S. Congress signed into law P.L. 104-172, more commonly known as the Iran-Libya Sanctions Act (ILSA). ILSA broke ranks with previous generations of U.S. sanctions by threatening to levy a tailored U.S. response (from a list of secondary sanctions) on foreign companies involved in Iranian energy investment.²⁹ The secondary sanctions aspect of ILSA motivated the European Union to lodge a formal complaint against the United States with the World Trade Organization.³⁰ Despite the strength of ILSA's legal structure, the actual impact of the law has been relatively light. Political maneuvering between the European Union and the Clinton and Bush Administrations reduced the likelihood that ILSA will ever be enforced.³¹

The first ten years of the new millennium were witness to unprecedented political and economic gains for the *Pasdaran*. IRGC representation expanded first in the municipal elections in 2003, then in parliamentary elections in 2004, and finally the presidency in 2005. Since election, President Ahmadinejad has proven so critical to consolidating IRGC gains that one Iranian newspaper, E'temad Melli, acerbically proclaimed GHORB the real winner of the 2005 presidential elections.³²

²⁶ Wehrey et al., *The Rise of the Pasdaran*, 59–60.

²⁷ Thaler et al., *Mullahs, Guards, and Bonyads*, 59.

²⁸ U.S. Department of the Treasury, *Office of Foreign Asset Control*.

²⁹ Kenneth Katzman, *The Iran-Libya Sanctions Act (ILSA) RS2071*, Economic analysis, (Washington D.C.: Congressional Research Service, 2006): 2–3.

³⁰ Jahangir Amuzegar, “Adjusting to Sanctions,” *Foreign Affairs* (May–June 1997): 36.

³¹ Katzman, *The Iran-Libya Sanctions Act*, 4–5.

³² Alfoneh, “How Intertwined Are the Revolutionary Guards in Iran’s Economy.”

After 2000, U.S. interest in deterring Iran and the IRGC has risen in parallel with IRGC status. The post-9/11 Bush Administration focused Iranian foreign policy efforts towards deterrence of WMD proliferation. Executive Order 13382, issued 25 October 2007, identified several of the *Pasdaran*'s major financial and commercial interests, prohibiting transactions between these entities and U.S. persons and freezing any assets held within the United States. This Order marked the first occasion that the United States targeted a foreign military with sanctions.³³

E. METHODS AND SOURCES

As the focus of this thesis is narrow, the effect of an evolving body of sanctions on the militarization of a government, the methodology best suited for this thesis is the single case study. The body of this thesis will employ a format similar to that of the literature review, incorporating a historic narrative with supporting economic data and analysis. The desired end state is the construction of a timeline that details the expansion of the IRGC into the both the licit and illicit sectors of the Iranian economy and provides a rigorous analysis of the interplay of the sanctions regime within that timeline. Following the temporal presentation of the material, the conclusion will consolidate the high points thematically into three separate gaps. While these gaps roughly correlate to the time periods delineated in the three main chapters, the gaps' contributions towards the militarization of Iran frequently overlap and cannot be so rigidly ascribed.

As might be expected, given the limitations on economic data volunteered by Iran, the body of formal literature dedicated to the post-Revolution Iranian economy is, at best, limited. Further complicating the matter, the *Pasdaran* are accountable only to the Supreme Leader and, as such, are unfettered by the paper trail normally generated through parliamentary oversight.³⁴ Fortunately, the scope of IRGC economic activity has grown too large to evade outside attention and chronicling this activity is beginning to gain some traction. The *Middle East Economic Digest* is a good source for articles

³³ Illias Shayera, *Iran's Economic Conditions: U.S. Policy Issues* (RL34525) (Washington D.C.: Congressional Research Service, 2010), 9.

³⁴ Kim Murphy, "Iran's \$12-Billion Enforcers: From Road-Building to Laser Eye Surgery, the Revolutionary Guard Dominates the Economy," *Los Angeles Times*, August 26, 2007: A1.

detailing major economic movement by the IRGC and IRGC-affiliated actors. Similarly, public policy think-tanks are coming into the arena of Iranian study. RAND and the American Enterprise Institute for Public Policy Research (AEI) have diligently generated reports, conferences, and monographs that penetrate deeper than most popular media treatment of the subject. Additional data for a more broad analysis of the Iranian economy is available from the statistical bellwethers, the World Bank, International Monetary Fund, and World Trade Organization.

The principal source for data detailing the history of U.S.-Iranian sanctions is the U.S. Treasury Department. The Office of Foreign Assets Control section of the Treasury Department website provides a comprehensive look at the legal framework for Iranian sanctions and includes all pertinent Executive Orders, U.S. Statutes, U.S. Codes of Federal Regulations, and Federal Register Notices.³⁵ This convenient grouping of primary sources enables and simplifies piecing together the timeline and scope of the last 31 years of U.S. sanctions. In addition, the Treasury Department website maintains an archive of official press releases. These releases offer valuable insight and context for each of the individual sanction programs, to include the underlying rationale and desired end-state.

F. FORMAT AND OVERVIEW

This thesis observes the standard convention of five chapter delineation to include: an introductory chapter, three chapters of research and analysis, and a concluding chapter. The three chapters that follow are dedicated to research and analysis of three consecutive time periods and chart the status of the sanctions regime against the growth of the *Pasdaran*. These chapters flow in a chronological order beginning at the founding of the Islamic Republic and continuing to the present. Chapter II covers the period from 1979 until the end of the Iran-Iraq War in 1988. Chapter III covers post-war reconstruction up to the presidential election of former IRGC commander, Mahmoud Ahmadinejad on July 24, 2005. Chapter IV covers the remaining five years, bringing this analysis up to the present nuclear crisis. Chapter V serves as the conclusion and

³⁵ United States Department of the Treasury, *Office of Foreign Asset Control*.

concisely reiterates the primary results of the thesis with an emphasis on future application to U.S. foreign policy and outline opportunities for further investigation of this topic.

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II. REVOLUTIONARIES TO REFORMERS (1979–1988)

A. REVOLUTIONARY SEED: THE ORIGIN OF THE IRGC

Following the overthrow of Shah Pahlavi in February 1979, Ayatollah Khomeini consolidated the partisan militias into the *Sepah-e Pasdaran-e Englab Eslami*. Initially, the Guards served as a foil to potentially volatile remnants of the Shah's professional armed forces; those that had not already been purged, imprisoned, or simply disappeared into the churning revolutionary masses.³⁶ The intentions guiding this ideologically-driven security force, however, extended far beyond providing a simple counterbalance to the remaining conventional forces.

Khomeini rightfully sensed both danger and opportunity in the absence of a unified purpose in the amalgam of dissatisfied and disenfranchised parties fueling revolutionary Iran. The Communist Tudeh Party, the bazaar merchant class, landed tribal chiefs, and rural notables represent just a few of the competing interests at work in the state during the Revolution.³⁷ This threat was not limited strictly ideological terms as many of these organizations brandished their own supporting paramilitary forces. In order to weave the various strands of the revolution into an Islamic context Khomeini required the support of a powerful backer; the IRGC was groomed to fill this role. Consequently, when Khomeini's first representative to the IRGC, Ayatollah Hassan Lahouti Eshkevari, attempted to subordinate the IRGC to the provisional government in lieu of Khomeini's Council of the Islamic Revolution, Khomeini had Eshkevari dismissed and later imprisoned and executed.³⁸ Hence, the primary role of the *Pasdaran* was advancing Khomeini's Islamic revolutionary agenda amidst the torrent of competing interests. Emphasis on this particular loyalty to the Islamic revolution is evident in the

³⁶ Ray Takeyh, *Hidden Iran: Paradox and Power in the Islamic Republic* (New York: Holt Paperbacks, 2006), 19.

³⁷ Abrahamian. *A History of Modern Iran*. 156–62.

³⁸ Ali Alfoneh, "Changing of the Guards: Iran's Supreme." American Enterprise Institute of Public Policy Research. April 2010. <http://www.aei.org/docLib/2010AprilNo1MiddleEasternOutlookg.pdf> (accessed August 20, 2010).

two primary documents that serve as the framework of the Revolutionary Guards Corps, the *Asasnameh-ye Sepah-e Pasdaran-e Enghelab-e Eslami* (Statute of the Revolutionary Guards Corps) and the Constitution of the Islamic Republic of Iran.³⁹

***Article 150:** The Islamic Revolution Guards Corps, organized in the early days of the triumph of the Revolution, is to be maintained so that it may continue in its role of guarding the Revolution and its achievements. The scope of the duties of this Corps, and its areas of responsibility, in relation to the duties and areas of responsibility of the other armed forces, are to be determined by law, with emphasis on brotherly cooperation and harmony among them.*⁴⁰

As the dialectic between Iran and the West unfolded from the 1980s through the present, this unique *Pasdaran* identity as guardians of the Islamic Revolution and its resonance with conservative elements of government would generate large amounts of social, economic, and political capital for the Guards.

B. INTRODUCTION TO INDUSTRY: IRGC AND THE IRANIAN MILITARY-INDUSTRIAL COMPLEX

The post-revolution metamorphosis of the Iranian defense industry is not an account of the eradication free-wheeling Schumpeterian entrepreneurs in favor of *Pasdaran* management; nor does it represent simply a change of letterhead from one state-based administrator to another, the character of this transformation lies somewhere in the middle of these two extremes.⁴¹ Iranian military industrialization did not graduate from relatively modest production (munitions, expendables, kit assembly, etc.) until the early 1970s. Shah Pahlavi, alarmed by Soviet geostrategic maneuvering in Iraq on the west and India to the east, dedicated an increasing share of the rising Iranian oil receipts towards acquisition and the indigenous development of modern weaponry.⁴² The Shah

³⁹ A copy of the *Asasnameh-ye Sepah-e Pasdaran-e Enghelab-e Eslami* [in Farsi] can be obtained through the Iranian parliamentary website: <http://tarh.majlis.ir/?ShowRule&Rid=1D4973FB-9551-4F8D-AEB3-DAEFD52791F1> (accessed July 20, 2010).

⁴⁰ Irano-British Chamber of Commerce, *The Constitution of the Islamic Republic of Iran*.

⁴¹ Joseph Alois Schumpeter, an Austrian economist, championed the role of the entrepreneur as the motive force behind the success of capitalism. More information on Schumpeter can be found at: <http://www.econlib.org/library/Enc/bios/Schumpeter.html> (accessed 28 July, 2010).

⁴² Schulz, "Iran: An Enclave Arms Industry," 148–9.

included an ambitious modernization program for Iran's defense manufacturing sector in his Third, Fourth and Fifth National Development Plans (1963–1978). This aggressive push for modernization resulted in nearly a seven-fold increase in defense expenditure between 1966 and 1973.⁴³

Modernization under the Shah involved collaboration with over a dozen American and European arms manufacturers; including major U.S. contractors Northrop, Grumman, Lockheed, Westinghouse, and Emerson.⁴⁴ Joint ventures with these defense industrial behemoths spawned the Iranian-based aircraft manufacturers, Iran Aircraft Industries (IACI) and Iran Helicopter Industries (IHI); research and development manufacturers, Iran Electronics Industries (IEI) and Iran Advanced Technology Corporation (IATC); and the telecommunications manufacturer, National Telecommunications System.⁴⁵ The Ministry of War managed the Iranian sides of these cooperative ventures under the umbrella corporation the Military Industries Organization (MIO). Therefore, while it is not accurate to label the defense industry under the Shah as privatized free enterprise, one can characterize the relationship as a generally transparent association between state-backed Iranian businesses and Western private defense corporations. However, this relative openness in the defense industry would not long survive the internal reshuffling occurring within the state as a result of the Revolution.

On the coattails of the founding of the Islamic Republic in December 1979, Khomeini wedded his ideological security apparatus, the *Pasdaran*, with the fragmented remains of the Military Industries Organization. However, this handoff of MIO to the IRGC was not the only, or even most significant, change to the state's military-industrial conglomerate during this period. Newly redubbed as the Defense Industries Organization (DIO), the conglomerate emerged from the Revolution without the benefit of its previous

⁴³ Robert Looney, "Origins of Pre-Revolutionary Iran's Development Strategy," *Middle Eastern Studies* (1986): 107–8.

⁴⁴ Schulz, "Iran: An Enclave Arms Industry," 152.

⁴⁵ *Ibid.*, 153–6.

partnership with the West.⁴⁶ Executive Order 12205, issued by U.S. President Jimmy Carter in response to the ongoing hostage crisis, made such partnerships with Iran illegal by prohibiting American companies from participating in Iranian industry and cutting off direct Iranian access to American-made goods.⁴⁷ Over the course of the following decade this loss of access to the American goods would produce some severe repercussions for Iran. As Khomeini attempted to march Iran through Baghdad down the “Road to Jerusalem,” shortfalls in the supply of foreign-sourced war materiel would beleaguer Iranian war efforts, reinforce Iranian inwardness and strengthen the position of the Guards.⁴⁸

C. EIGHT YEARS IN ECONOMIC ABYSS: THE IRAN-IRAQ WAR

The origin of the Iran-Iraq War is an area of popular dispute. Iranian interference in Iraqi domestic politics is likely one contributing factor. Another probable piece of the puzzle is rooted in the border dispute between Iraq and Iran. Iraqi people generally viewed Iraq’s loss of control over the entirety of the Shatt al-Arab waterway, partially ceded to Iran in the 1975 Algiers Agreement, as a particularly humiliating concession.⁴⁹ Iraqi abrogation from the Algiers Agreement preceded invasion by a mere six days and is considered by some as the Iraqi declaration of war.⁵⁰ Finally, the diplomatic isolation of post-revolutionary Iran from the United States, the primary source for Iranian advanced weapons procurement, training and maintenance, significantly increased Iran’s exposure

⁴⁶ Alfoneh, “How Intertwined Are the Revolutionary Guards in Iran’s Economy,” 3; An overview of the products offered by Defense Industries Organization may be found at its website: <http://www.diomil.ir/en/home.aspx> (accessed July 20, 2010).

⁴⁷ For a summary of sanctions during this period, see the Appendix.

⁴⁸ “The Road to Jerusalem Goes through Baghdad,” and “War, War Until Victory,” were slogans employed by the Khomeini government to rally support for continuing Iran’s involvement in the Iran–Iraq War. Abrahamian, *A History of Modern Iran*, 171.

⁴⁹ Will D. Swearingen, “Geopolitical Origins of the Iran-Iraq War,” *The Geographical Review*, (October 1988): 408–16.

⁵⁰ Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 9.

to attack. This vulnerability in Iranian regional prominence offered Iraq the opportunity to ascend in terms of national and regional prestige and assume a leadership role in the post-Arab nationalism regional order.⁵¹

Efraim Karsh argues that the principle reason behind Iran drawing out the Iran-Iraq War was that the conflict provided an opportunity to consolidate the Iranian Revolution into a solidly theocratic movement.⁵² Violation of Iranian territorial sovereignty by secular Iraq offered an ideal opponent against which to stress the Shi'a Islamic aspect of the Iranian identity. Supporting the war against Iraq became a national and religious endeavor. Furthermore, austerity measures adopted by the government to fund the war evoked a sense of shared sacrifice among the Iranian populace.⁵³ Perhaps, nowhere else in Iran was this concept of sacrifice displayed more conspicuously than in the ranks of Iran's ideological soldiers, the *Pasdaran* and the *Basij*.

The duality of Ayatollah Khomeini's power, his religious and political authority, allowed the cleric to equate the death of a partisan soldier with a paradise-warranting act of martyrdom. During the war, Iran adopted a strategy of using superior numbers (fielding soldiers at a ratio of approximately three to one) to offset Iraq's considerable materiel advantage. Hence, the Iranian front generated wave upon wave of poorly trained young men and boys armed with little more than Khomeini's plastic key to Paradise.⁵⁴ One important outcome from these suicidal campaigns against the Iraqi war machine was that it cemented public perception of the *Pasdaran* and the *Basij* as the de facto guardians of the state. Popular recognition, however, came with the price of a tremendous death toll and represented just one of the exorbitant costs of the "imposed" war.

The tremendous economic costs generated during conflict produced a devastating effect on the Iranian economy and exacerbated the economic decline that accompanied the post-Revolution instability. This combination of instability and war expenditure

⁵¹ Thom Workman, "The Social Origins of the Iran-Iraq War," *Centre for International and Strategic Studies Working Papers #5* (Ontario: Centre for International Strategic Studies, 1991: 6–7).

⁵² Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 71.

⁵³ Farideh Farhi, "New Hardships Intensify Debate Over Iran-Iraq War," *Inter-Press Services*, August 3, 2010. <http://ipsnews.net/print.asp?idnews=52372> (accessed September 10, 2010).

⁵⁴ Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 62.

accounted for a drop in foreign exchange reserves of over \$13 billion in the first two years of the Islamic Republic.⁵⁵ Moreover, hydrocarbon revenues, the prime vehicle for replenishing foreign reserves, dropped off sharply during this period.⁵⁶ Despite the concerted effort to sustain oil production throughout the war, productivity in the Iranian oil sector fell off during the period of 1979–1988, the victim of nationalization and subsequent mismanagement as well as the considerable wartime damages to the Iranian oil extraction and delivery infrastructure. As a result, Iranian oil revenues during the Iran-Iraq War dropped to an average of 67 percent of pre-war revenues in spite of the rise in average oil prices to 138 percent of pre-war prices (1970–1979).⁵⁷ Additionally, defense expenditure ballooned at the expense of government investment in other areas of large public sector. Furthermore, the high casualty rate sustained throughout the war combined with the large pockets of refugees displaced by the fighting to create a shortage in the accessibility of skilled labor. The diversion of labor and capital away from more productive activity resulted in sustained drops in investment and productivity and an overall negative growth output.⁵⁸ Hence, the portion of the Iranian domestic economy not associated with the war effort continued to wither as the war stagnated, further reducing the number of available jobs; by 1987 unofficial estimates of Iranian unemployment reached nearly one half of the labor force.⁵⁹

1. Defense Spending

As previously mentioned, the Iranian economy experienced strain from the exceptionally high rate of defense expenditure maintained throughout the war. Defense expenditure rose to an extraordinary average of 16.9 percent of total government

⁵⁵ Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 74.

⁵⁶ Roger Stern, “The Iranian Petroleum Crisis and United States National Security,” *Proceedings of the National Academy of Sciences of the United States of America* 104, no. 1 (2007): 377–382.

⁵⁷ Oil prices calculated on the average of inflation adjusted annual global oil prices (2008 USD = 100). Prewar averages are based on years 1970–1979. Iran-Iraq War averages are based on years 1980–1988. Oil revenues are based on the average of years 1980–1988 compared with the average of 1978 and 1979 revenues. Revenue figures collected from Abrahamian, *A History of Modern Iran*: 175.

⁵⁸ Verma, “The Role of Capital Formation,” 3.

⁵⁹ Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 86.

expenditure between 1981 and 1986.⁶⁰ However, as is shown on the following page in Figure 1, this sharp rise in defense expenditure is not mirrored by a similar jump in total military imports. On the contrary, trending in Iranian arms imports diverges radically between the 10-year period prior to the Revolution and the three decades of the Islamic Republic that followed. In a single year, arms imports dropped from 3.5 billion USD and a positive rate of slightly over 500 million USD per annum to a 600 million USD and a negative rate of more than a 13 million USD per annum.

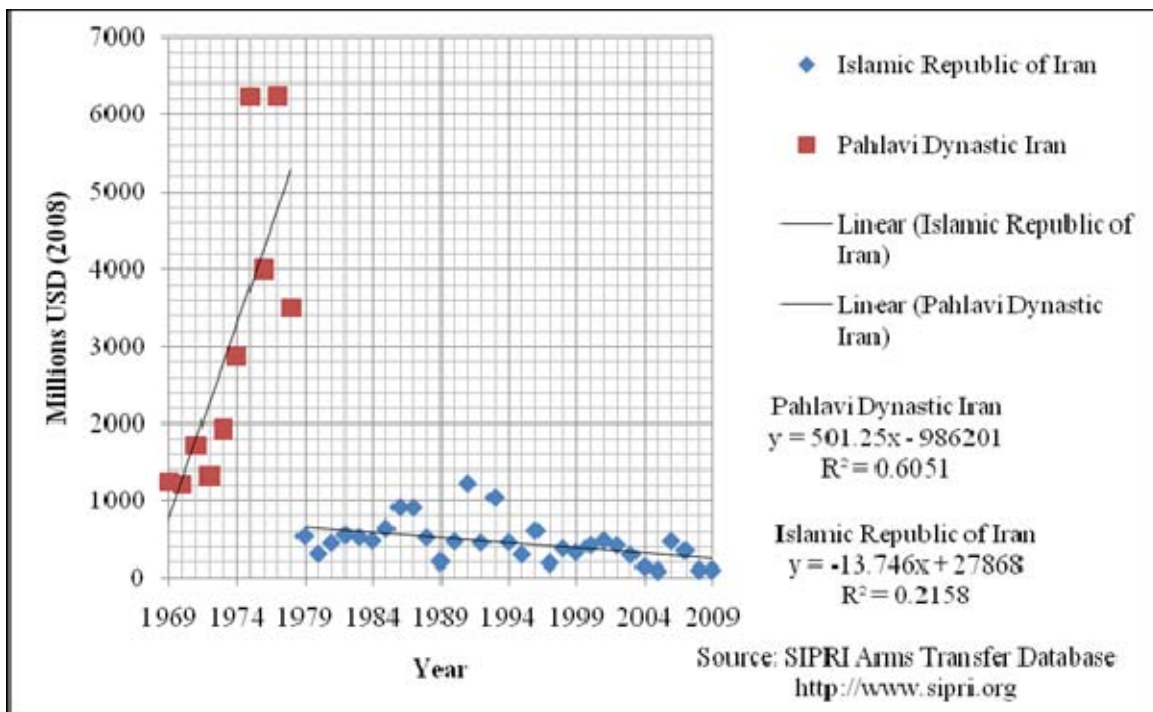


Figure 1. Iranian Arms Imports (1969–2001)

⁶⁰ Verma, “The Role of Capital Formation,” 3.

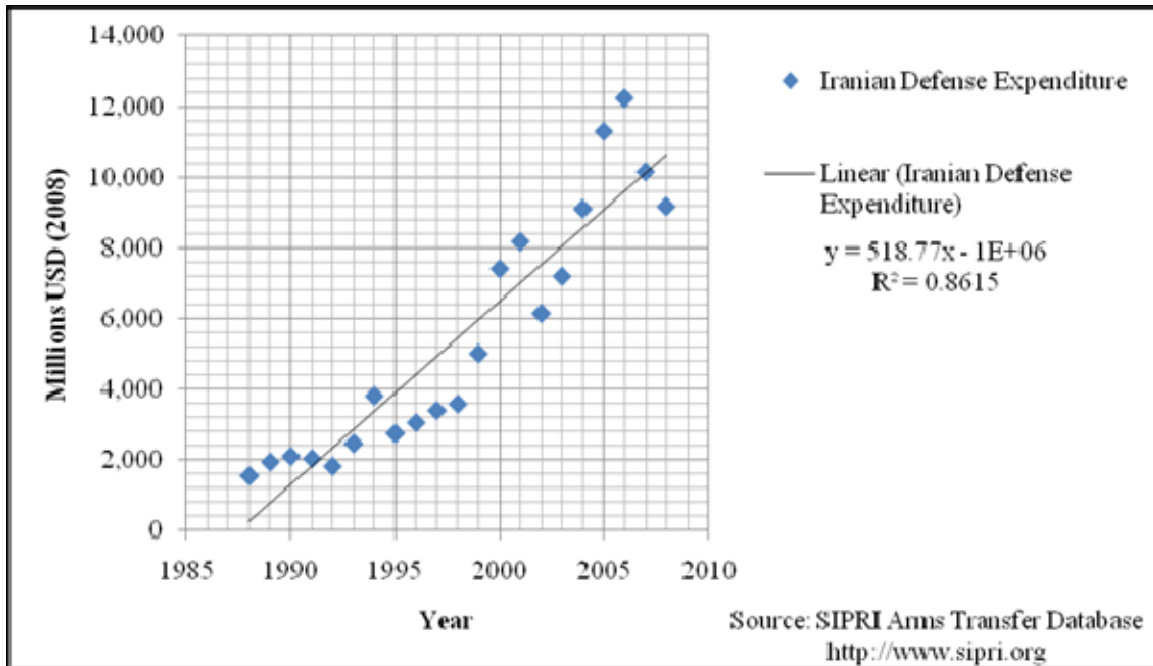


Figure 2. Iranian Defense Expenditure

It may be reasonably assumed that the Iranian demand for weapons and materiel during a period of protracted warfare would not drop considerably from the prewar period that preceded it. While the precise Iranian order of battle is not currently available, estimates of equipment and unit end strengths are available through the International Institute for Strategic Studies' annual *Military Balance* almanacs. A survey of the almanacs covering the Iran-Iraq War period shows that, for the most part, domestically produced Iranian military hardware was not fielded during the war. This is not to imply that the initiative to *expand* Iranian domestic arms production was unsuccessful. In fact, by the late 1980s Iran had eclipsed several venerated arms producing nations (Austria, the Scandinavian countries, and Belgium), employing an estimated 240 defense-manufacturing sites and approximately 12,000 workshops engaged in research and production of military equipment.⁶¹ As a result of all this investment, by the end of the Iran-Iraq War Iran had developed the capability to domestically produce armored vehicles, light and heavy weaponry, advanced missile systems, aircraft parts,

⁶¹ Anoushiravan Ehteshami, "Iran Boosts Domestic Arms Industry." *Janes International Defence Review*, April 1, 1994: 72.

artillery systems, and radar and air defense systems.⁶² This build up in Iran's defense-related industrial capacity is important in developing this thesis because by the end of the war the *Pasdaran* had access to the manufacturing and construction infrastructure and personnel and this access granted the organization considerable advantage in the coming decades. The following section will argue that the impetus behind this surge in domestic defense spending is rooted in U.S. sanctions.

2. Sanctions and the Embargo

The opening volley in the lengthy chronicle of sanctions against Iran preceded the Iran-Iraq war but would remain in effect long after the last shots were fired. President Carter initiated the first U.S. sanctions against Islamic Republic in response to the student-led takeover of the U.S. Embassy in Tehran and the ensuing hostage crisis. On November 12, 1979, Carter authored Proclamation 4702, invoking the presidential powers detailed in the Trade Expansion Act of 1962, in order to block the import of Iranian crude oil into the United States. Two days after the release of 4702, Carter issued Executive Order 12170, freezing all Iranian government assets subject to U.S. jurisdiction. As the hostage situation stagnated and relations between the United States and Iran continued to deteriorate, the Carter administration broadened the reach of punitive sanctions. Carter's next two executive orders directed at Iran, E.O. 12205 and E.O. 12211, both issued in April of 1980, formally ended among other things direct access to American-made manufacturing and consumer goods, access to U.S. financial markets, and the participation of U.S. companies in the tendering of Iranian industrial service contracts.

A change in the White House following the 1980 presidential elections saw the end of the hostage situation in Iran and the lifting of Carter's embargo. In accordance with U.S. obligations in the Algiers Accords, Iran's release of the American hostages led

⁶² Jane's Information Group. *Iran: Defence Industry* (Washington D.C.: Jane's World Defence Industry, 2009).

to implementation of Executive Orders 12276 through 12284 that removed most of the prohibitions enacted under E.O. 12205 and E.O. 12211 and administratively set the stage for the return of frozen Iranian assets.

Although the embargo was officially over, relations between Tehran and Washington remained tepid and the new Reagan administration kept intact the policy of refusing the direct sale of U.S. arms and equipment to Iran. As war broke out between Iran and neighboring Iraq and Iranian demand for war materiel spiked, this unwillingness on the part of the United States to deal with Iran would not prove to be sufficient measure to keep U.S. manufactured arms and spare parts out of the hands of the Iranian military. This is true because the United States, while largely successful in preventing American companies from engaging in direct sales to Iran, was either unable or unwilling to address the resale and transshipment of military goods by third parties. Therefore, at the start of the war Iranian access to American military equipment was both constrained and more expensive (due to the addition of an intermediary broker) but still available.⁶³

The bombing of the U.S. Marine barracks in Beirut on October 1983 brought an end to U.S. tolerance of third party weapons channels into Iran.⁶⁴ Iranian support for Islamic Jihad, the group deemed responsible for the Beirut attack, established the theme for the next phase of dysfunction between Iran and the United States. On 19 January 1984 the U.S. Secretary of State formally determined, under the auspices of the Export Administration Act, that Iran had repeatedly “provided support for acts of international terrorism” and added Iran to the U.S. list of State Sponsors of Terrorism. Classification as a state sponsor invoked several articles in the Arms Export Control Act and Export Administration Act of 1979, which, in turn, established a new formal weapons embargo against Iran. The two Acts worked in concert to automatically block all transfers of technology and equipment to Iran that could enhance its military capability or its ability

⁶³ Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 19.

⁶⁴ U.S. General Accounting Office (GAO) *Terrorism: Laws Cited Imposing Sanctions on Nations Supporting Terrorism* (Report 133073) Washington D.C.: U.S. General Accounting Office, 1987.

to support terrorism.⁶⁵ Iran's designation as a state sponsor also strengthened the hand of the U. S. Department of State as it began to apply diplomatic pressure to the home countries of Iran's third party suppliers.

On 15 December 1983, the State Department implemented a plan to further reduce Iranian access to military equipment. Dubbed Operation Staunch, the effort sought to cut the flow of American-made and other foreign military equipment into Iran from any country that maintained or desired a strong relationship with the United States.⁶⁶ Michael Armacost, Under Secretary of State for Political Affairs during the Reagan Administration, described the operation as a series of "vigorous diplomatic efforts, through intelligence-sharing and strong demarches, to block or complicate Iranian arms resupply efforts on a worldwide basis."⁶⁷ Operation Staunch continued for the duration of the Iran-Iraq War and is generally regarded as a successful campaign despite several conspicuous violations of the effort by the United States, itself.

3. Rhetoric Versus Reality

There is a temptation when examining the anti-West vitriol being broadcast out of the Islamic Republic during the late 1970s and 1980s to come to the conclusion that the dire state of international relations between Iran and the West automatically precluded cooperation. If this were true it would consign the employment of American wartime sanctions against Iran to the dustbin of superfluous excess. Indeed, even a brief survey of Iranian propaganda during this period would demonstrate that the two states Khomeini publically deems most antithetical to the Revolution are the United States and Israel. Israel, the "Little Satan," receives condemnation as the "origin of anti-Islamic propaganda" and a collaborator with Shah for the oppression of Iranian and Palestinian

⁶⁵ GAO, *Terrorism: Laws Cited*.

⁶⁶ Trita Parsi, *Treacherous Alliance: the Secret Dealings of Israel, Iran, and the United States* (London: Yale University Press, 2007): 113–4.

⁶⁷ Michael Armacost, *U.S. Policy in the Persian Gulf and Kuwaiti Reflagging*. Senate Foreign Relations Committee testimony, Washington D.C.: U.S. Department of State, Bureau of Public Affairs, 1987.

Muslims.⁶⁸ The United States, the “Great Satan,” receives similar treatment for its history of interference in Iranian politics, in particular, for its close sponsorship of the Shah and its role in Operation Ajax, the joint CIA-MI6 led coup d'état that reinstalled the Pahlavi dynasty to the seat of Iranian power.⁶⁹ However, as the identity of the Revolution solidified, particularly after the 1981 purge of the Communists, the isolationist stance of the Islamic Republic began to give way to a more pragmatic approach to the outside world.⁷⁰ As history shows, if loggerheads in the international arena been sufficient to block cooperation between Iran and the West, it would have later spared Iran, Israel and the United States from some particularly embarrassing revelations.

In 1981, rumors began to circulate in Tehran alluding to ongoing and highly secretive cooperation between Iran and Israel; charges that Ayatollah Khomeini vehemently denied. Despite the Supreme Leader's claims to the contrary, researchers have since uncovered a paper trail that brought to light a history of weapons exchanges between Iran and Israel. The arrangement, dating back from early 1980 and continuing through late 1983, involved Israel providing weapons caches to Iran in exchange for access to Iranian oil. Exchanges between the two states resulted in a total of receipts topping \$500 million.⁷¹ Israeli national interests were realized through the reestablishment of Iranian oil flow but also, in lending support to a peripheral threat, Israel was making progress towards neutralizing the much greater proximate threat coming from Iraq. Israeli involvement in behind-the-scenes deals with Iran was not limited to direct deals between the two states, officials from the Jewish state would also later play a third party role in the U.S.-Iranian arms debacle.

November 25, 1986, several years after the implementation of Operation Staunch, President Reagan made a nationally televised appearance in an attempt to defuse the political firestorm brewing over Washington. Controversy erupted after the Western

⁶⁸ Takeyh, *Hidden Iran*, 192–7.

⁶⁹ Ibid., 15–7.

⁷⁰ Roger M. Savory, “Religious Dogma and Economic and Political Imperatives,” in *Iran at the Crossroads: Global Relations in a Turbulent Decade*, Miron Rezun, 35–67 (Boulder, CO: Westview Press, 1990), 58–9.

⁷¹ Mattair, *Global Security Watch-Iran*, 35.

media picked up on an article in the Lebanese news magazine *Ash Shiraa* alleging secret arms deals between Iran and the United States.⁷² As more details of the plot began to surface, so too did the evident contradictions in U.S. foreign policy. The sale of TOW and Hawk missile systems to Iran in exchange for the release of American hostages being held by Iranian-backed Hezbollah represented, at its core, a blatant violation of the U.S.-led arms embargo.⁷³ A bruised and embarrassed Reagan administration emerged from the Iran-Contra Scandal but still made the important decision to bolster rather than abandon the U.S. commitment to Operation Staunch and keeping arms out of Iran.

From the Iranian perspective, the sensitive nature and high potential political costs associated with maintaining a hard rhetorical line against the West while simultaneously conducting clandestine arms deals with the West leads to an important conclusion. The unofficial arms embargo continued under the Reagan administration and later buttressed by the State Department's Operation Staunch ostensibly stopped the flow of critical military equipment into Iran. Second, despite the large amount of capital provided to the DIO for the duration of the war, Iran was unable to meet its own wartime demands for manufacturing military equipment.

4. Passing the Poison

American sanctions offered another boon to both the military and leadership of Iran; sanctions offered a scapegoat. When Khomeini was finally compelled to drink from the poisoned chalice and sue for peace on 20 July 1988, America's involvement in the war (on behalf of Iraq) offered Khomeini an obvious target at that to spit the poison back.⁷⁴ The Iranian government promoted the Iran-Iraq War as an opportunity to reshape the regional power structure with Iran in its rightful place as the Middle Eastern hegemon and an Islamic crucible where the faith and numbers of the Iranian forces would prevail

⁷² George Cave, "Why Secret 1986 U.S.-Iran 'Arms for Hostages' Negotiations Failed," *Washington Report on Middle East Affairs* (September/October 1994): 8, 89.

⁷³ Parsi, *Treacherous Alliance*, 125–6.

⁷⁴ In his ceasefire declaration, Khomeini likens this decision to withdraw from the war as being deadlier than drinking from a poisoned chalice. Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 79.

in the face of the well-equipped, secular Iraqi Army.⁷⁵ For the duration of the Iran-Iraq War, the prominence of the *Pasdaran* on the battlefield steadily increased at the expense of the professional Iranian army. By the midpoint of the war the Artesh had ceded most operational planning and execution to the *Pasdaran*.⁷⁶ Given its prominent role in the final conduct of the war, the IRGC was in a prime position to inherit the blame for the lack of any appreciable Iranian gains at the conclusion of the war. The United States, by withholding military assistance to Iran and actively discouraging assistance from other countries, became the target for deflecting criticism away from the government and its preferred military force, the *Pasdaran*.⁷⁷

D. CONCLUSION

During the first nine years of the Islamic Republic, the regime of sanctions constructed under the Carter and Reagan Administrations contributed to securing a niche for the *Pasdaran* in the Iranian economy. This is not meant to imply that sanctions alone meet the requirements for necessity or sufficiency as a causal factor in the early stages of the empowerment of the IRGC. As this chapter has endeavored to illustrate, Ayatollah Khomeini possessed a vested interest in promoting the *Pasdaran* as it served the function of security apparatus for his particular element of the 1979 Revolution. However, as this section argues, the effects of these sanctions manifested in ways that contributed to the eventual success of the *Pasdaran*.

Recalling the first hypothesis introduced in Chapter I, *Sanctions created a military-industrial gap in Iran on which the IRGC could capitalize*, an examination of the Revolutionary and Iran-Iraq War periods shows that the abrupt withdrawal of U.S. defense manufacturers from the Iranian defense industry created a large gap in Iran's capacity to produce defense materiel. This productivity gap proved particularly significant to Iranian security during the 1980s as the state embarked on its costly eight year war with Iraq. The Carter administration stopped direct sales of U.S. manufactured

⁷⁵ Karsh, *Essential Histories: The Iran-Iraq War 1980–1988*, 71–3.

⁷⁶ Ibid., 45–8.

⁷⁷ Amuzegar, "Iran's Economy and the U.S. Sanctions," 185–6.

arms and materiel to Iran through an executive order based embargo. The Reagan administration continued the weapons embargo, initially, through an informal policy of prohibiting arms sales to Iran. Iranian designation as a State Sponsor of Terror in 1983 triggered articles in the Arms Export Control Act and Export Administration Act of 1979 and formalized the prohibition on weapons sales to Iran. The following year the U.S. State Department exacerbated the Iranian defense gap with the implementation of Operation Staunch. By targeting the third party suppliers acting as clearing houses for weapons shipments, Operation Staunch attempted to sever the back channel flow of U.S. weapons into Iran.

The Islamic Republic endeavored to alleviate the gap in foreign-sourced combat equipment with massive investment in domestic defense production and the adoption of human wave tactics. As the Iran-Iraq War drudged on, Iranian defense expenditure ballooned, averaging nearly 17 percent of GDP. The *Pasdaran*, due to their position at the helm of the Iranian defense manufacturing conglomerate, Defense Industries Organization, were uniquely situated to capture this windfall defense spending. By the mid-1980s Iran is estimated to have been operating 240 defense-manufacturing sites and 12,000 workshops. Hence, as the dust settled and the Iranian government took stock of the damage to the country's infrastructure and the economy in general, the Guards, with their surplus of personnel and manufacturing and construction equipment, were ideally positioned to carve out a large slice of the Iranian economy for themselves in the coming decade.

Again, it is important to recognize that the *Pasdaran* functions as the security apparatus for the theocratic government, and, in all likelihood, Ayatollah Khomeini entrusted the DIO to the IRGC as another mechanism to strengthen IRGC position relative to the regular armed forces. However, it is unlikely that Khomeini and the Islamic Republic would have directed such a large portion of Iranian resources toward the development of Iranian defense manufacturing if sanctions limiting access to ready-made and superior American-made equipment were not firmly in place. The "imposed war" with Iraq represented one of the ideological crown jewels for the Iranian revolutionary experiment and Khomeini and his supporters undertook great sacrifices to

achieve victory. This idea is supported by the fact that over the course of the war Iran engaged in multiple arms deals with the two countries to which it was most ideologically opposed, Israel and the United States.

Sanctions during this period of time would also prove beneficial to the *Pasdaran* with respect to the second hypothesis, *Sanctions allow IRGC to capitalize on identity as guardians of Islamic Revolution*. The conduct of the Iran-Iraq War, in particular the employment of a war of attrition strategy and human wave tactics, engendered the *Basij* and the *Pasdaran* with bona fides in terms of dedication to the state and its Islamic government. However, as the war progressed and the IRGC assumed a greater leadership role in combat operations the fate of the *Pasdaran* became increasingly tied to the outcome of the conflict. At the conclusion of the war, having failed to produce any returns for Iran, the regime and its security apparatus used the United States as a means to deflect criticism from the regime. Khomeini specifically points towards the U.S. embargo and its role in keeping all arms and equipment out of Iran as one of the fundamental causes for the lackluster performance of the Iranian security forces.

III. BUILDING UP THROUGH RECONSTRUCTION (1989–2004)

This [IRGC involvement in the Iranian economy] all started with Rafsanjani saying: go and make money, and they went and did this and thought, this is easy.

Ali Ansari⁷⁸

A. POST-WAR CHANGES

The period following the Iran-Iraq War is one marked by change on both sides of the Iranian-American dialectic. In Tehran, the death of the Revolution's charismatic leader, Ayatollah Ruhollah Khomeini, combined with a lingering sense of public dissatisfaction with the outcome of the war to substantively change the character and base of the theocracy. In Washington D.C., the startling discovery of an advanced Iraqi unconventional weapons program generated new concerns in the United States with respect to the possibility of similar programs or ambitions coming out of other regional actors. Iran was prime candidate for focusing these new concerns due to its previous attempt at constructing a nuclear program under Shah Pahlavi, possession of vast natural resource wealth and established track record for supporting terrorist organizations.

1. Moderation in the Elected Officials

Backlash from the Iran-Iraq War damped the popular revolutionary fire in the Islamic Republic. A tattered economy, damaged and aging public infrastructure and ailing Khomeini led to a popular reshaping of the elected government into an organ more focused on domestic concerns than exporting revolution to the oppressed. Presidents Rafsanjani (1989–1997) and Khatami (1997–2005) brought into office a new paradigm of economic liberalization and pragmatism. In practice, though, this new paradigm would still be tempered by a smaller, though indefatigably influential, conservative cleric base. Economic agendas under the liberalizers included building free markets, encouraging

⁷⁸ Julian Borger and Robert Tait, "The Financial Power of the Revolutionary Guards," *The Guardian* (home page), February 15, 2010, <http://www.guardian.co.uk/world/2010/feb/15/financial-power-revolutionary-guard/print> (accessed September 16, 2010).

foreign investment in Iran, and privatizing the *bonyads* (large para-statal foundations that dominate the Iranian economy). The Rafsanjani government also tested improving relations with the United States, awarding a one billion dollar oilfield development contract to the U.S. oil company Conoco.⁷⁹ However, this is not to imply anything more than a signal for cautious rapprochement from the Iranian presidency as diplomatic overtures from both the Rafsanjani and Khatami governments fell short of requests for direct talks with their respective U.S. administrations.⁸⁰

Popular reformist sentiment was only partially mirrored in the highest echelon of Iranian government. Shortly before his death, Khomeini replaced his longtime heir-apparent to Supreme Leader, Ayatollah Hussein Montazeri, with President Ali Khamenei. This last minute reshuffling of the line of succession occurred as a result of Montazeri breaking ranks with the conservative *ulama* (religious leadership) party line. Ayatollah Montazeri became a liability to conservatives when his letters to the Supreme Leader, articles in the *Kayhan* daily paper, and nationally broadcast speeches began to criticize the brutish tactics employed by the regime to consolidate power and silence dissent.⁸¹ The popularity of Montazeri insulated him against direct attack from the conservative element his rhetoric was alienating. Khamenei, on the other hand, did not enjoy the same level of popular support as Montazeri and, therefore, would not command the same degree of latitude and independence from the conservative clerical base. By replacing Montazeri with Khamenei the conservative element of Iranian politics believed they could establish a dependency in the Supreme Leader and maintain a core of power for the benefit of conservative members of the *ulama*.⁸² However, in practice the ongoing rule of Ayatollah Khamenei does not exhibit such an unrepentantly conservative stripe. Instead, the pragmatic Khamenei has utilized temporary alignments with virtually all of Iranian powerbrokers in an effort to remain atop of the factious theocracy. Conservative

⁷⁹ Thomas R. Mattair, *Global Security Watch-Iran: A Reference Handbook* (Westport, CT: Praeger Security International, 2008), 47.

⁸⁰ Mattair, *Global Security Watch-Iran*, 47–9.

⁸¹ Baqer Moin, *Khomeini: Life of the Ayatollah* (New York: Thomas Dunne Books, 2000): 280–3.

⁸² Takeyh, *Hidden Iran*, 33.

clerics, however, were not the only bulwark against Iranian transformation. Events and perceptions outside of Iran would act to similarly constrain changes, particularly in terms of Iranian relations with the United States and the West.

2. Containment and Concern

Two years after the conclusion of the Iran-Iraq War, Saddam Hussein gathered the sizable modern army he had assembled during the 1980s, marshalling them towards the southern Iraqi border and the rich oilfields of Kuwait. In response, the United States gathered a coalition of 32 states, eight of which were regional states, against its former ally Iraq. In Tehran, Khamenei and Rafsanjani adopted an “active neutrality policy” for Iran that kept the republic on the sidelines for the duration of the war.⁸³ However, Iran’s abstention from the war would not lead to any appreciable rapprochement with the United States.⁸⁴ On the contrary, as the war unfolded, the U.S. perspective of the entire Middle East became colored by the discovery of a surprisingly advanced Iraqi nuclear program. The secret Iraqi program prompted a renewed American suspicion of other regional actors and resulted in a strengthening of U.S. efforts to keep weapons of mass destruction and missile technology out of the Middle East. George H.W. Bush’s Middle East Arms Control Initiative is one of the first of these efforts that would ultimately elevate the issue of nuclear arms (and the broader category of weapons of mass destruction) to the status of cause celeb; a status it would enjoy for at least the next two decades of U.S.-Middle Eastern politics.

The question naturally arises as to why the Middle East is deserving of such singular attention with respect to the nuclear issue. Beyond the inherent risks associated with the addition of any nuclear-armed state to the international community, the Bush White House suggested that the Middle East of the 1990s exhibited several factors that compounded the potential threat of a new nuclear state. First, both sides of the Iran-Iraq War employed chemical warfare along the front lines and, in so doing, established a

⁸³ Mohsen Milani, “Iran’s Post-Cold War Policy in the Persian Gulf” *International Journal* 49, no. 2 (1994): 340.

⁸⁴ Mohsen Milani, “Power Shifts in Revolutionary Iran.” *Iranian Studies* (summer-autumn 1993): 373.

precedent within the region for the utilization of unconventional weapons.⁸⁵ Second, Saddam Hussein's attempts to obfuscate his nuclear program and obstruct IAEA inspections after the war demonstrated a strong desire to maintain its clandestine nuclear weapons program in spite of its discovery and subsequent international condemnation.⁸⁶ Third, the vast hydrocarbon wealth within the region generates revenue streams for the governments of resource-endowed states that require little oversight or transparency. Hence, a decade before the threat of WMDs became the oft-touted *casus belli* of the second U.S.-led war in Iraq, it had already established a pattern of shaping U.S. regional policy. Among the various policy manifestations of the Middle Eastern nuclear concern was a sizable augmentation of the sanctions program against Iran.

B. CLINTONIAN EXECUTIVE ORDERS AND CONGRESSIONAL ACTS

In addition to Iran's status as a State Sponsor of Terrorism (Hezbollah, Hamas, and Palestine Islamic Jihad), the nuclear threat generated the requisite political will in the executive and legislative branches of the U.S. government to coerce change in Iran through political and economic isolation. The 1990s saw actions from both the White House and Congress in an effort to contain Iran through a series of legislative acts and executive orders.

The Iran-Iraq Arms Non-Proliferation Act of 1992, P.L. 102-484 brought Iran under the umbrella of several sections of the Iraq Sanctions Act of 1990, P.L. 101-513. This new law echoed the sentiment of the White House's Middle East Arms Control Initiative in its focus on preventing the transfer to Iraq or Iran of "any goods or technology, including dual-use goods or technology, wherever that transfer could materially contribute to either country's acquiring chemical, biological, nuclear, or destabilizing numbers and types of advanced conventional weapons."⁸⁷ The Iran-Iraq

⁸⁵ "Fact Sheet: Middle East Arms Control Initiative," U.S. Department of State Dispatch, June 3, 1991, 393. <http://www.proquest.com/> (accessed September 20, 2010).

⁸⁶ *Ibid.*

⁸⁷ This excerpt is from Section 1602 of the Iran-Iraq Arms Non-Proliferation Act of 1992. The Act can be found in its entirety at <http://www.nti.org/db/china/engdocs/iraniraq.htm> (accessed September 20, 2010).

Arms Non-Proliferation Act has successfully triggered sanctions against twelve entities since its inception.⁸⁸ Executive Order 12938, issued by the Clinton administration on November 14, 1994, was not aimed specifically at Iran but affected the state tangentially with its treatment of the proliferation of WMD technology. Under E.O. 12938, states accused of proliferating WMD technology faced the loss of U.S. foreign assistance, access to credit and Multilateral Development Bank assistance, access to U.S. arms and national security-sensitive goods and technology, and additional imports and exports restrictions.⁸⁹ The Order did not find much traction prior to its inclusion in the Iran Nonproliferation Act of 2000 and Executive Order 13382; which will be discussed in Chapter IV. However, sanctions issued under the auspices of preventing Iran from obtaining weapons of mass destruction, as later Clintonian executive orders and the Iran and Libya Sanctions Act of 1996 would demonstrate, were not going to be strictly confined to actual transfers in weapons or weapon technology.

1. Iranian Vulnerability

The aging and underdeveloped Iranian energy sector became the target of opportunity for sanction efforts throughout the middle to late 1990s. Hydrocarbon production, a historically important source of revenue for the Islamic Republic, has accounted for a figure between 20 and 30 percent of Iranian gross domestic product over the lifetime of the theocracy and over 60 percent of the revenue of the state.⁹⁰ Iran ranks in the top three countries in the world in terms of proven reserves of oil (ranking third) and natural gas (ranking second).⁹¹ However, before Iran could capitalize on its natural resource potential, the state would require modernization of its entire oil infrastructure in conjunction with the development of a liquefied natural gas infrastructure sufficient to tap the vast Iranian natural gas deposits. Iranian policy makers, in an acknowledgement of

⁸⁸ Broken down by country of origin these entities include: nine Chinese, two Indian, and one Jordanian company. The summary and Federal Register Notices can be found at <http://www.state.gov/t/isn/c15237.htm>.

⁸⁹ E.O. 12938 is summarized in Appendix of this thesis, and the full text can be found at the U.S. Treasury website <http://www.ustreas.gov/offices/enforcement/ofac/legal/EO/12938.pdf>.

⁹⁰ Katzman, *The Iran-Libya Sanctions Act*, 1.

⁹¹ U.S. EIA, *Country Analysis Brief: Iran: Natural Gas*.

the disrepair of their energy sector, partially abrogated from the revolutionary mandate prohibiting foreign firms from participating in domestic natural resource production. The government introduced a system of buyback contracts that allowed foreign firms to develop Iranian oilfields in exchange for a share of state production from the National Iranian Oil Company (NIOC). Under the terms of the buyback contracts, foreign firms were responsible for the construction and initial operation of oilfield infrastructure but would gradually cede control of day-to-day operations to NIOC until the state had gained complete control over the production facilities at the end of the contract.

This requirement for foreign sources of capital and technical expertise to develop the Iranian energy sector allowed U.S. policy makers to target the flow of oil by discouraging American and foreign investment. First, the theory followed that stunted growth in the energy sector would then deprive Iran of the requisite resources to continue the development of its nuclear program or continue its funding of terrorist activities abroad.⁹² Second, oil revenues are a sensitive domestic political issue in that they fuel Iran's vast subsidy program. These subsidies represent an increasingly costly endeavor but have become enmeshed in the practice of Islamic egalitarianism and, thus, in the social contract with the state. During the buildup to the Revolution, Ayatollah Khomeini promised that the new regime would, "build real estate, make water and power free, and make buses free," and such promises are not easily cast aside.⁹³ The disruptive potential of limiting or eliminating subsidies was revealed in 2007 after government attempts to ration fuel led to rioting and demonstrations in Tehran and several other major cities.⁹⁴ Energy subsidies, specifically subsidies on gasoline, are particularly vexing to the economy as demand for subsidized gasoline in Iran has increased on the order of 11–12 percent per annum for the previous two decades.⁹⁵ The International Monetary Fund calculated energy subsidies at approximately 17.5 percent of Iranian GDP (2006) and

⁹² Katzman, *The Iran-Libya Sanctions Act*, 1.

⁹³ Stern, "The Iranian Petroleum Crisis and United States National Security."

⁹⁴ Nazila Fathi, Fuel Rationing in Iran Prompts Protests, *New York Times*, June 27, 2007.

⁹⁵ Stern, "The Iranian Petroleum Crisis and United States National Security," 381.

rising.⁹⁶ Thus, hampering the development of the Iranian energy sector offered the direct benefit of decreasing the amount of revenue available to the government and the indirect benefit of placing pressure on the regime by threatening the state subsidy program. With this desired end state clearly in focus, the White House and Congress enacted a series of measures to ramp up the economic pressure on Iran.

On March 15, 1995, President Clinton issued Executive Order 12957 prohibiting American investment in the Iranian energy sector. E.O. 12957 came just ten days after Rafsanjani's alleged appeal for more open economic relations between Iran and the United States, the one billion dollar contract to U.S. oil company Conoco to develop the Sirra A and E oil fields.⁹⁷ Within two months the Clinton White House extended the reach of U.S. sanctions, issuing Executive Order 12959 (May 6, 1995) that banned all U.S. trade with Iran as well as eliminating Iranian access to American finance and investment organs. Executive Order 13059, issued August 19, 1997, consolidated and clarified E.O. 12957 and E.O. 12959, reiterating the U.S. position that virtually all trade and investment activity in Iran was prohibited. The centerpiece for countering Iranian nuclear ambitions, however, originated not in the White House, but the U.S. Capital Building.

2. Iran and Libya Sanctions Act of 1996

The Iran and Libya Sanctions Act of 1996 (ILSA), P.L. 104–172, and its subsequent forms, represented the most comprehensive unilateral sanctioning to date targeting development in the Iranian energy sector. What set ILSA apart from previous sanctions rounds was that ILSA sought to make the threat of sanctions more universal; thus, making the sanction affects more comprehensive and preventing U.S. companies from being singularly disadvantaged to global competitors that were not similarly constrained from participating in the development of the Iranian energy sector. In order

⁹⁶ Keith Crane, Rollie Lal, Jeffrey Martini, *Iran's Political, Demographic, and Economic Vulnerabilities*. Santa Monica, CA: RAND, 2008.

⁹⁷ Richard Sabatini, "Economic Sanctions: Pressuring Iran's Nuclear Program." *Nuclear Threat Initiative*, February 18, 2010, http://www.nti.org/e_research/e3_economic_sanctions_pressuring_iran_nuclear_program.html (accessed September 17, 2010).

to accomplish these ends, ILSA created a menu of six secondary sanctions and a combination of two of these six sanctions were to be applied to any company investing more than 20 million dollars in Iran. The secondary sanctions aspect of ILSA generated considerable acrimony from the European Union and prompted the EU to lodge a formal complaint against United States with the World Trade Organization.⁹⁸ The Clinton White House, not wishing to bring about unnecessary estrangement from its European allies, gradually backed away from enforcing ILSA. Hence, the actual effectiveness of ILSA in deterring foreign investment in Iran remains a matter of some debate.

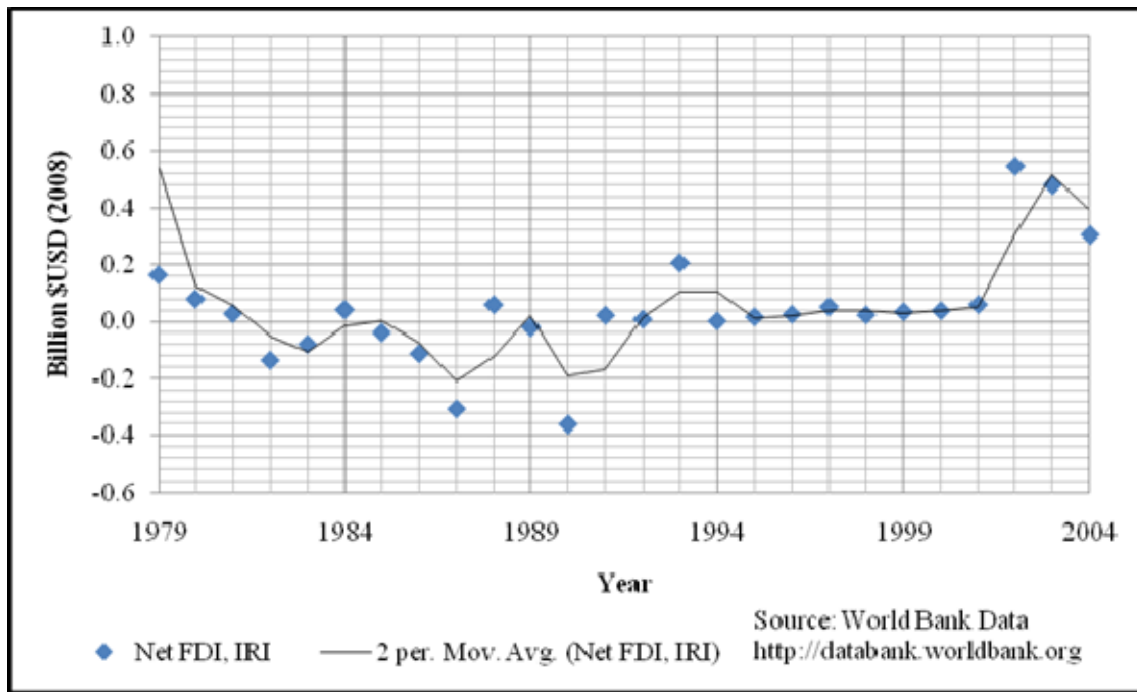


Figure 3. Net FDI Flow in the Islamic Republic of Iran (1979–2004)

⁹⁸ Amuzegar, “Adjusting to Sanctions,” 36.

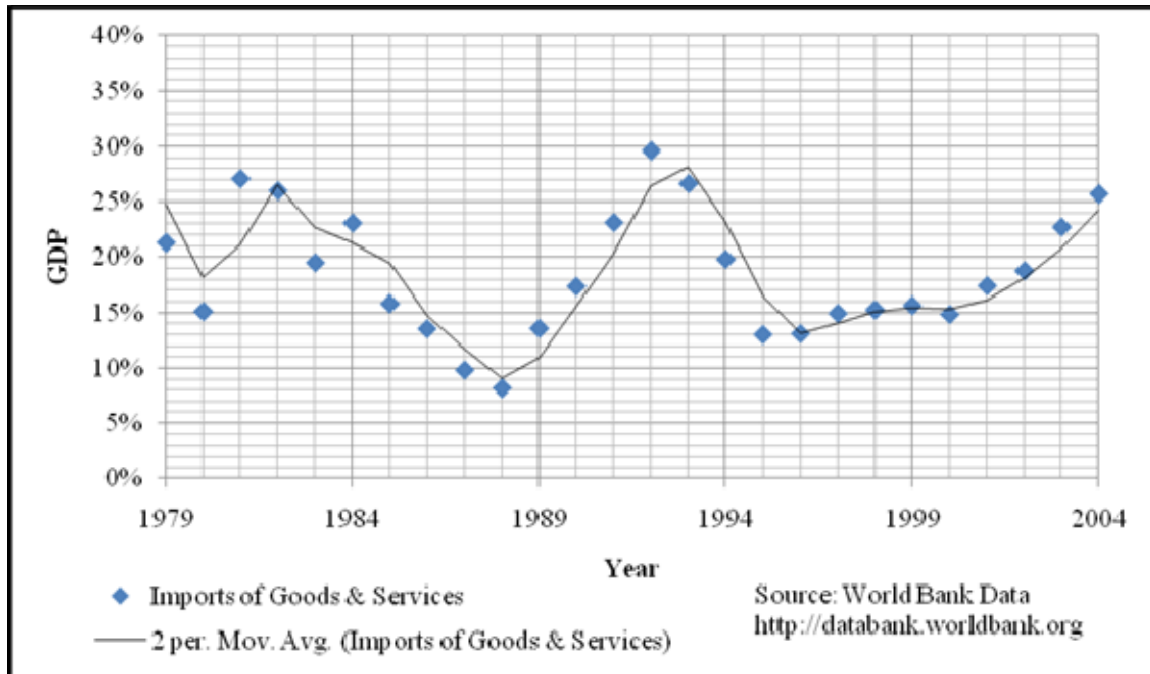


Figure 4. Imports of Goods & Services as Percent GDP (1979–2004)

A 2006 Congressional Research Service report shows that although ILSA may have initially acted as a strong deterrent to investment in Iranian oil and gas production, after the Clinton Administration issued the first ILSA waiver in 1998 investment in Iran - reached a total \$11.5 billion over the course of next five years (1999–2004).⁹⁹ This trend agrees with values expressed in Figures 3 and 4, which show relatively flat values throughout the mid to late 1990s followed by a large uptick in both net foreign direct investment and value of imports coming into Iran after 2001. However, while this investment is not to be discounted, energy market analysts generally agree that the level of investment is still far below the amount required to completely modernize the energy sector.¹⁰⁰ The Iranian refining infrastructure remains hopelessly outdated, with the average gasoline production per barrel of oil trailing that of modern refineries by roughly

⁹⁹ Katzman, *The Iran-Libya Sanctions Act*, 3–4.

¹⁰⁰ Stern, “The Iranian Petroleum Crisis and United States National Security,” 378–9.

50 percent.¹⁰¹ Furthermore, the list of energy-related companies capable of bridging this gap and willing to conduct business with Iran is short and shrinking.¹⁰²

C. THERMIDOR AND REFORM

As mentioned in the beginning of this chapter, post-war elected officials in the Iranian government began to reflect less revolutionary zeal in favor of a more domestically focused approach to the day-to-day ministering of the theocracy. The passing of Ayatollah Khomeini and his subsequent replacement with then-President Ali Khamenei shifted much of the informal political power away from the position of Supreme Leader.¹⁰³ Consequently, in executing the duties of his office, Khamenei became more reliant on co-opting parallel sources of power than his predecessor. Iran's new President, Ali Hashemi Rafsanjani, represented a natural ally for Khamenei. Prior to assuming office, Rafsanjani had worked hand in hand with Khamenei as part of the Assembly for Reconsideration of the Constitution. The primary task of the Assembly was to recast the presidency through a series of constitutional reforms, transforming the office from its previous primarily ceremonial function of state figurehead into a position with some real political power. These measures centralized power and instilled the presidency with greater executive authority by removing the post of Prime Minister and transferring those powers to the president, creating the presidentially-appointed office of a Vice President, and allowing the president to select and dismiss ministers (pending *Majlis* approval).¹⁰⁴

As Rafsanjani assumed the new duties of his office, he formed a liberalizing duumvirate with the Supreme Leader. Together, Khamenei and Rafsanjani set about on a series of structural reforms ending the practice of rationing, easing price controls,

¹⁰¹ Crane et al., Iran's Political, Demographic, and Economic Vulnerabilities, 90.

¹⁰² The Iran Energy Project (a program sponsored by the Foundation for Defense of Democracies) maintains a webpage which tracks high profile energy companies discontinuing ties with Iran. For more information see <http://www.iranenergyproject.org/companies-cutting-ties-with-iran.pdf> (accessed October 25, 2010).

¹⁰³ Abrahamian. *A History of Modern Iran*, 182.

¹⁰⁴ Mohsen Milani, The Evolution of the Iranian Presidency: From Bani Sadr to Rafsanjani: 93–6.

attempting to balance the national budget, cutting defense expenditure to less than two percent of the budget, and launching a very effective campaign to control Iran's birth rate.¹⁰⁵ For the purposes of this thesis the efforts of Khamenei and Rafsanjani toward balancing the budget and cutting defense spending are particularly salient issues. Some of the policies crafted to achieve these fiscally responsible ends effectively unleashed the IRGC into the entire Iranian economy.

In order to bring the national budget into balance the post-war Iranian government began to focus more of its attention on efforts to control public spending. The defense budget, already receding from its wartime high water mark, offered one potential area for deeper cuts. Culling defense spending from the national budget, however, presented some considerable potential drawbacks for Iran. First, Iraq, the source of the recent "imposed" war, remained a serious threat and regional rival. The Iraqi military benefitted significantly from connections with the world's major arms suppliers during the war. Iraqi military power increased not only through the growing sophistication of its equipment but through a tremendous expansion in size; having grown from a quarter of a million people in 1980 to one million in 1990.¹⁰⁶ While a substantial portion of the Iraqi war machine was destroyed during the First Gulf War, the elite Iraqi Republican Guard forces were left largely untouched by the fighting and continued to represent a considerable threat to neighboring Iran. Second, as mentioned in the previous chapter, the Iranian economy at the end of the war was in the midst of record unemployment and therefore not in a position to absorb a large influx of military veterans into the labor market. Given this situation, Rafsanjani confronted strong economic reasons to decrease the size of the military as well as strong economic and security reasons to maintain its strength. In response, the government adopted a policy that would spur Iranian reconstruction, cut defense costs, and largely retain the force structure of the *Pasdaran*: the solution was to essentially privatize the Guards' marketable services.

¹⁰⁵ Abrahamian, *A History of Modern Iran*, 183–4.

¹⁰⁶ Figures are taken from *The Military Balance* almanacs 1980–1981 and 1989–1990.

D. GHORB & ECONOMIC EMPIRE BUILDING

The underlying legal justification for the *Pasdaran*'s current ubiquitous presence in the Iranian economy can be traced back to Article 147 of the Iranian constitution.

*Article 147: In time of peace, the government must utilize the personnel and technical equipment of the Army in relief operations, and for educational and productive ends, and the Construction Jihad, while fully observing the criteria of Islamic justice and ensuring that such utilization does not harm the combat-readiness of the Army.*¹⁰⁷

In order to generate revenue, the IRGC leveraged the engineering capacity developed during the Iran-Iraq War and through the conglomeration of businesses within its associated bonyads to found *Gharargah Sazandegi Khatam al-Anbia*, more commonly known by its abbreviation Ghorb. The engineering firm has since grown to monolithic proportions employing an estimated 25,000 engineers and staff personnel.¹⁰⁸ Hefty resourcing does not necessarily correlate with effective business practices. As a Tehran-based private contractor would later complain:

They [Ghorb] have more equipment and finance than any other contractor in the country. But they aren't professional, they aren't a normal company and they don't play by the same rules. There's nothing you can do, nobody you can complain to.¹⁰⁹

Ghorb executives are quick to point out that Ghorb activity outside the military realm represents a modest portion of its total operations, comprising only 30 percent. However, independent verification of this claim or others regarding Ghorb's activity is difficult to accomplish as the conglomerate has not been forthcoming in providing the details of its many alleged contracts (both completed and ongoing) to the Iranian press.¹¹⁰ The nature of Ghorb becomes even more opaque when it comes to the matter of where and how the profits from its entrepreneurial activities are spent.

¹⁰⁷ Irano-British Chamber of Commerce, *The Constitution of the Islamic Republic of Iran*.

¹⁰⁸ Wehrey et al., *The Rise of the Pasdaran*, 60.

¹⁰⁹ Angus McDowell, "Ghorb's Contracting Coup," *Middle East Economic Digest* (July 7, 2006): 6.

¹¹⁰ McDowell, "Ghorb's Contracting Coup," 6.

1. Ghorb and the Oil Industry

Iranian Oil Minister Kazem Vaziri-Hameneh's statement during the recent signing of a gas pipeline contract that, "the Oil Ministry has started a new move, aimed at taking advantage of all existing potentials in the country" is indicative of the new major economic inroad for the Guards.¹¹¹ The steep run-up of oil prices during between 2000 and 2007 should have bolstered Iran's Foreign Exchange Reserve and fueled a healthy Oil Stability Fund. Instead, Iranian oil revenues began to fall under the weight of sagging production and spiraling domestic consumption. The paradox of rising oil prices and shrinking oil revenues led the Oil Ministry to sound the alarm in September of 2006, claiming that Iranian oil revenues could continue to slide at an annual rate of 13 percent without the addition of significant investment to the energy sector.¹¹²

The under-developed Iranian energy sector, favored target of Clinton era sanctions, has provided fertile ground for Ghorb's economic ambition. Since 2006, Ghorb has won multiple lucrative contracts to develop the energy sector including a \$2 billion contract for the second phase of the developing the South Pars gas field and a \$1.3 billion contract for a gas pipeline extending to the border with Pakistan.¹¹³ In February of this year, the Treasury Department raised pressure on development firms operating in Iran. This increased pressure led to Shell, Total, Respol, and a consortium of several Turkish developers disabusing themselves of Iranian tenders.¹¹⁴ As the European firms were withdrawing from Iran, President Ahmadinejad began telling Ghorb executives to prepare to "enter high-end oil and gas activities in order to satisfy the domestic needs of the country."¹¹⁵ This phenomenon is consistent with previous instances in the Islamic Republic when foreign competition contracted, the domestic activity expanded. However, the growing political presence of the Guards (post-2003) and the codependency

¹¹¹ McDowell, "Ghorb's Contracting Coup," 6.

¹¹² Lionel Beehner, *Tehrans Oil Dysfunction*, Council on Foreign Relations, February 16, 2007, http://www.cfr.org/publication/12625/tehrans_oil_dysfunction.html (accessed October 20, 2010).

¹¹³ Dubowitz, "The Sanctions on Iran Are Working."

¹¹⁴ Ali Alfoneh, "The Revolutionary Guards' Looting of Iran's Economy" AEI.

¹¹⁵ Ibid.

between the Guards and the executive means that domestic economic opportunity in the new millennium is becoming the exclusive domain of the Guards and their coterie.

2. Sanctions in the Dialogue Between the People and the State

Sanctions have found a place in the dialogue between the people and the state as a way to justify internalization. From the pulpit of the Tehran Friday morning prayer service Mohammad Emami Kashani recently included the message that, “in light of recent sanctions, economic cohesion should be placed higher on the agenda,” advocating for listeners to withdraw foreign held capital and consume domestically produced goods.¹¹⁶ **President Ahmadinejad has also been quick to characterize sanctions as an, “opportunity to develop our own products and globalize Iranian products.”¹¹⁷ Considering the large IRGC presence in the economy, the Guards have interests in sectors as diverse as automobile manufacture, tourist resorts, life insurance, and laser eye surgery, the organization stands to benefit greatly through increased internalization of demand.¹¹⁸ The IRGC’s media outlets and educational material also rationalize the Pasdaran presence in Iranian culture and societal affairs through the lens of sanctions, claiming that such a presence is needed to counter the “U.S. assault” and that intervention in the economy is necessary to protect Iran from sanctions regimes.¹¹⁹ Hence, as sanctions assist the ongoing militarization of Iran, they also provide a convenient tool for rationalizing the takeover.**

¹¹⁶ Stephen Szrom and David Pupkin, “Sanctions on Iran: Reactions and Impact,” *AEI: Iran Tracker*, August 10, 2010, http://www.irantracker.org/us-policy/sanctions-iran-reactions-and-impact#_edn10 (accessed August 13, 2010).

¹¹⁷ Szrom and Pupkin, “Sanctions on Iran.”

¹¹⁸ Murphy, “Iran’s \$12-Billion Enforcers,” A1.

¹¹⁹ Jane’s Islamic Affairs Analyst, “Indoctrinated to Intervene: Iran’s IRGC,” Jane’s Defence, February 6, 2009, http://search.janes.com/Search/documentView.do?docId=/content1/janesdata/mags/jiaa/history/jiaa2009/jiaa5185.htm@current&pageSelected=allJanes&keyword=IRGC&backPath=http://search.janes.com/Search&Prod_Name=JIAA& (accessed August 23, 2009).

E. SMUGGLING NETWORKS

Sanctions are shifting the flow of goods into Iran underground and into the smuggling networks. The Clintonian Executive Orders placed obvious restrictions on the export and re-export/transshipment of American-made with E.O. 12959 and 13059, but one Order, E.O. 12938, placed restrictions on the supply of many foreign produced goods as well. Under E.O. 12938, the United States threatened to impose sanctions against states it deemed to be involved in proliferating WMD technology; inherent in the definition of proliferation is the transfer of anything from the large basket of goods and technologies that meet IAEA criteria for dual-use. These goods do not lose their appeal or utility for Iranian consumers simply because they appear on a sanctions list. Furthermore, the blanket of “dual-use” is fairly general and covers many items have common commercial and industrial applications.¹²⁰ Hence, as demand within Iran for sanctioned goods persists, sufficient demand will eventually draw a supply; a supply facilitated, in this case, through smuggling. It then follows that the broader the swath of sanctions in place the more goods will be diverted into transnational smuggling networks. As it so happens, smuggling networks have grown over the last two decades and become a considerable economic opportunity for the IRGC; the *Pasdaran* charge of guarding the Revolution has translated into an informal role as the head of Iranian black market.

1. By Sea

The nexus for much of the smuggling activity into Iran is the United Arab Emirates (UAE). According to a 2010 Government Accounting Office report on sanction effectiveness, the UAE has functioned as the source for more than half of the U.S. Justice Department cases against intermediaries.¹²¹ Dubai, second largest of the seven Emirates that comprise the UAE, is known colloquially as the “best city in Iran,” and is home to

¹²⁰ The 2006 IAEA *Guidelines for Transfers of Nuclear-Related Dual-Use Equipment, Materials, Software and Related Technology* contains an appendix which describes items considered to be dual-use and can be found on the Nuclear Suppliers Group website: <http://www.nuclearsuppliersgroup.org/Leng/PDF/infirc254r7p2-060320.pdf> (accessed October 21, 2010).

¹²¹ U.S. Government Accounting Office, *Iran Sanctions: New Act Underscores Importance of Comprehensive Assessment of Sanctions' Effectiveness* (GAO-10-928T) (Washington, D.C.: U.S. Government Accounting Office), 4.

over nine thousand Iranian businesses and more than 400,000 Iranian nationals.¹²² Dubai is characterized as an “absolute sieve” and that at any given time along the docks of Dubai Creek, dhows are being outfitted with goods destined for Iran.¹²³ As Babak Dehghanpisheh illustrates in his article, *Smugglers for the State*, that the strengthening of the Iranian sanctions regime has produced a significant change in the character of Dubai’s seagoing traffic; wherein container ships are being replaced by a steadily growing fleet of smugglers.¹²⁴ The smuggling fleet out of the UAE accounts for over 50 percent of the total traffic, intermingling with ships from Malaysia and Singapore, that account for an additional 20 percent, as well as ships from Australia, Canada, and the European countries Austria, France, Germany, Luxembourg, the Netherlands, and the United Kingdom.¹²⁵ This shift in the flow of trade from legitimate channels into smuggling has proven to be a very beneficial arrangement for the IRGC. In following this illicit flow of goods across the Persian Gulf into Iran there is a very good chance of encountering the *Pasdaran* at some stage in the process.

On the receiving end, Mehdi Karrubi, Speaker of the Majlis and outspoken critic against conservative elements of the government, made waves in Tehran by becoming the first politician to disclose the existence of over 60 illegal docks operating under the jurisdiction of the IRGC.¹²⁶ These docks exist to circumvent both Iranian and international oversight and service the fleet of smugglers moving goods into Iran. Ali Qanbari, member of the Majlis, claims that over one-third of the nation’s imports are

¹²² Thaler et al., *Mullahs, Guards, and Bonyads*, 59.

¹²³ Kambiz Foroohar, “Dubai Helps Iran Evade Sanctions as Smugglers Ignore U.S. Laws,” *Bloomberg*, January 25, 2010, http://www.bloomberg.com/apps/news?pid=21070001&sid=av5smtYe_DDA (accessed October 19, 2010).

¹²⁴ Babak Dehghanpisheh, “Smugglers for the State,” *Newsweek*, July 10, 2010, <http://www.newsweek.com/2010/07/10/smugglers-for-the-state.print.html> (accessed September 20, 2010).

¹²⁵ GAO, *Iran Sanctions*, 4.

¹²⁶ Mehdi Khalaji, *Iran’s Revolutionary Guards Corps, Inc. Policy Watch#1273*, Policy Paper (Washington D.C.: The Washington Institute for Near East Policy, 2007).

sourced through the underground economy and these unauthorized docks.¹²⁷ However, the IRGC smuggling network, while based primarily along the jetties of southern Iran, is not restricted to the Persian Gulf coastline.

2. By Air

The *Pasdaran* are also believed to maintain a network of import/export sites at over 20 major airports throughout Iran.¹²⁸ In this case, IRGC presence entails anything from exclusive control over a portion of the airport's customs receiving area to providing security for the entire airport. The most dramatic display of IRGC control over the airports occurred on May 8, 2004 when the Guards garnered international attention with their opening day takeover of the Imam Khomeini Airport. In order to make their intentions unmistakable, the IRGC positioned tanks to block the airport runways, preventing outbound flights and forcing the diversion of all inbound to adjacent airports. Analysts speculate that the IRGC takeover was motivated partially in retaliation against the Iranian government for passing over the IRGC contract bid in favor of management by the Turkish-Austrian consortium Tepe-Akfen-Vie and partially to ensure that *Pasdaran* could maintain control over Iran's newest and largest international airport.¹²⁹ Even without considering the underlying motivations, the Imam Khomeini Airport takeover is telling in that it illustrates the growing independence of the *Pasdaran* from the government.

3. IRGC Incentives

Control over the estimated \$12 billion Iranian smuggling network benefits the IRGC and its nebulous web of front companies and affiliates at several different levels.¹³⁰ First, the IRGC derives revenue directly from smugglers. According to sources within smuggling network, the *Pasdaran* charge a fee when intercepting

¹²⁷ Khalaji, *Iran's Revolutionary Guards Corps*.

¹²⁸ Ibid.

¹²⁹ Borger and Tait, "The Financial Power of the Revolutionary Guards."

¹³⁰ Dehghanpisheh, "Smugglers for the State."

smugglers at sea, though rarely confiscate illicit cargo, and a fee to use the aforementioned network of illegal docks.¹³¹ These fees could be absorbed by the smuggler but are more likely transferred through intermediaries to the consumer in the form of a larger premium on smuggled goods. Second, by establishing their organization's own free trade ports affiliate companies and patrons of the IRGC benefit from not having to pay the IRGC imposed smuggling fees or the average 26 percent tariffs (2008) applied to imports by the Iranian government.¹³² Finally, while revenues garnered from smuggling activity benefit local *Pasdaran* commanders they also find their way into the Guards' central financial network. The IRGC Cooperative Foundation, the Mehr Finance & Credit Institution, the Ansar Financial and Credit Institute, and a host of smaller financial institutions consolidate the Guards' economic gains.¹³³ This resource pool offers the IRGC the requisite liquidity to be a major player in the Tehran Stock Exchange and Iranian privatization efforts, a topic that will be explored in greater detail in Chapter IV.

F. CONCLUSION

The post-war period of IRGC activity in the Islamic Republic largely falls within the third hypothesis: *Sanction effects on private enterprise are greater than sanction effects on IRGC*. The death of the Ayatollah Khomeini effectively brought an end to the era of populist rule over the Islamic Republic. Khamenei, successor to Khomeini, was selected by *ulama* sponsors in an effort to prevent the marginalization of conservative element, but has since proven to be a more moderate pragmatist and cautious supporter of governmental reform. In concert with Khamenei, the Rafsanjani and Khatami presidencies introduced modest political, economic, and social reforms. Included in these reforms was a new policy that encouraged the IRGC to participate in the private economy as well as a renewed effort to lure foreign investment into Iran. However, as Iran

¹³¹ Dehghanpisheh, "Smugglers for the State."

¹³² World Trade Organization, "Iran, Islamic Republic of," <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=IR> (accessed October 28, 2010).

¹³³ Ali Alfoneh, "What Would Really Work to Stop Iran's March to Nukes," <http://www.aei.org/print/pub=article&pubId=102306&authors=> (accessed October 5, 2010).

endeavored to open its economy the U.S. Congress and the Clinton White House endeavored to keep Iran isolated. To these ends, the aging Iranian hydrocarbon infrastructure was of particular interest to the United States for deterring Iran's nuclear ambitions. The IRGC benefitted from the sanctions-based prohibition of American competition and from U.S. efforts to pressure other foreign firms from participating in Iranian development and reconstruction.

The sanctions regime of the 1990s and early 2000s managed to have some success in constraining the legitimate flow of goods into Iran. Unfortunately, Iranian domestic demand for dual-use and American-made goods did not fall in concert with the legitimate supply and, thus, squeezed the supply of these goods into the transnational smuggling networks. The IRGC dominates Iranian smuggling through an informal network of jetties and presence in key airports. The *Pasdaran* benefits directly from smuggling activity from the fees it imposes on goods smuggled into Iran. *Pasdaran* affiliated companies are exempted from having to pay this IRGC premium (as well as import duties imposed by the state) and gives them a considerable cost-savings over less well connected private competitors.

This chapter also explored the continuing role of the second hypothesis, *sanctions allow IRGC to capitalize on identity as guardians of Islamic Revolution*, in shaping the internal dialogue within Iran. In addressing public concern over the growing influence of the IRGC, both the state and the *Pasdaran* attempt to paint the IRGC's political, social, and economic presence as an effort to shield the Iranian people against their enemies abroad. In this way, the Guardians of the Revolution protect Iranian society from the corruption and cultural erosion associated with Western influence while the Guard's expanding economic role mitigates the potential damage that sanctions could cause to the Iranian economy.

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IV. PRESIDENCY AND PRIVATIZATION (2005-2010)

The IRGC is so deeply entrenched in Iran's economy and commercial enterprises, it is increasingly likely that, if you are doing business with Iran, you are doing business with the IRGC.

U.S. Treasury Secretary Henry Paulson¹³⁴

A. THE PERSISTENCE OF THE NUCLEAR ISSUE

The nuclear issue remains the predominant issue standing between Iran and the United States. While this chapter primarily concerns events from 2005 onward, the Iran Nonproliferation Act of 2000, P.L. 106-178 and its expansion via the Iran Nonproliferation Amendments Act of 2005, are worthy of mention here. The Iran Nonproliferation Act is significant for the realm of international business in that the Act, like ILSA before it, applies secondary sanctions against foreign firms providing assistance to Iran.¹³⁵ Under P.L. 106-178, foreign firms are once again subject to penalties for noncompliance; adding the penalties of Executive Order 12938 to those of the Arms Export Control Act and the Export Administration Act. Unlike ILSA, however, the Iran Nonproliferation Act has been invoked to apply extraterritorial sanctions to foreign firms over 80 times since being signed into law and has, therefore, set a much more threatening precedent of U.S. action against foreign firms operating in Iran.¹³⁶

In the early and middle part of the first decade of 2000, much of the previous attention paid to the Iranian nuclear threat was directed elsewhere. In the wake of the 9/11 terrorist attacks, the focus of the United States was fixed on the two new U.S. military theaters in Afghanistan (Operation Enduring Freedom) and Iraq (Operation Iraqi

¹³⁴ U.S. Department of the Treasury, "Statement by Secretary Paulson on Iran Designations," *U.S. Department of the Treasury: Press Room*, 25 October, 2007, <http://www.ustreas.gov/press/releases/hp645.htm> (accessed July 6, 2010).

¹³⁵ The complete text for the Iran Nonproliferation Act of 2000 can be found on the Government Printing Office website: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_cong_public_laws&docid=f:publ178.106.pdf.

¹³⁶ A list of companies sanctioned under the Iran Nonproliferation Act of 2000 can be found at the U.S. State Department website: <http://www.state.gov/t/isn/c15234.htm>.

Freedom). This lapse in attention proved to be only temporary as several recent events brought the Iranian nuclear issue back into focus for U.S. policy makers and popular media. In September of 2009, Iran divulged the existence of a secret uranium enrichment facility outside of the sacred city of Qom, a site known to Western intelligence circles since 2007.¹³⁷ Furthermore, in the five months following its acknowledgement of the facility at Qom, Tehran disclosed plans to construct an additional 10 enrichment facilities to the International Atomic Energy Agency and touted its achievement of the 20 percent uranium enrichment benchmark.¹³⁸

In response to the Iranian nuclear threat, on 1 July 2010, President Obama signed the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISAD), H.R. 2194, into law. The specifics of CISAD are discussed in detail at a later point in this chapter, however, the Act warrants mention here as it depicts the strong resurgence concern within the United States with regard to Iranian nuclear ambitions. As evidence, while the sunset provision of H.R. 2194 requires that Iran to cease, “providing support for acts of international terrorism,” in addition to ending its, “pursuit, acquisition, and development of nuclear, biological, and chemical weapons and ballistic missiles and ballistic missile launch technology,” the justifying sections are heavily slanted towards the nuclear issue. Nine items out of ten in the Section 2, *Findings*, and six items out of eight in Section 3, *Sense of Congress*, directly relate to the Iranian nuclear program.¹³⁹

B. CHANGING OF THE GUARDS: POLITICIZATION

Ayatollah Khomeini cautioned against the mixing of the military and politics in his last will and testament, writing:

¹³⁷ “Iran has Second Enrichment Site,” BBC, September 25, 2009, <http://news.bbc.co.uk/2/hi/8274262.stm> (accessed October 13, 2010).

¹³⁸ “Implementation of the NPT Safeguards Agreement and relevant provisions of Security Council resolutions 1737 (2006), 1747 (2007), 1803 (2008) and 1835 (2008) in the Islamic Republic of Iran,” IAEA, February 18, 2010, <http://www.iaea.org/Publications/Documents/Board/2010/gov2010-10.pdf> (accessed October 13, 2010).

¹³⁹ H.R. 2194 is summarized in Appendix A and the full text is available at the U.S. Government Printing Office website: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h2194enr.txt.pdf (accessed October 13, 2010).

*My emphatic counsel to the armed forces is to observe abide by the military rule of non-involvement in politics. Do not join any political party, group or faction. No military man, security policeman, no Revolutionary Guard or Basij may enter into politics.*¹⁴⁰

In spite of the clarity of this admonition and the historic alignment between the *Pasdaran* and the revolutionary founder, the last several years have proven to be a very successful period for a cadre of politically savvy Guardsmen. During the Majlis elections in February 2004, almost 60 percent of the elected officials (91 of the 152) could claim a background in the IRGC.¹⁴¹ Presidential elections the following year included three candidates, in addition to Ahmadinejad, with an association to the IRGC. By late 2009, 34 former IRGC officers were filling senior-level posts in the government including over half of the Ahmadinejad presidential cabinet.¹⁴²

The growing the political presence of the IRGC is consistent with the expansionist interpretation of Article 150 adopted by many of the *Pasdaran* and their supporters. Article 150 states that the IRGC will maintain, “Its role of guarding the Revolution and its achievements.”¹⁴³ Under this broad context, senior leadership in the IRGC has proselytized and mobilized against various “counter-revolutionary” factions, the list of that includes some of the highest members of the Iranian government. During the Rafsanjani era, the public schism between the president and senior IRGC leaders, particularly IRGC chief Major General Mohsen Rezai, played out in the headlines of Iranian newspapers and erupted in violent clashes between security forces and liberal activists at Iranian universities and cinemas.¹⁴⁴ One month after the surprising results of the 1997 presidential election, which resulted in political outsider Mohammad Khatami receiving almost 70 percent of the votes, Supreme Leader Khamenei removed General

¹⁴⁰ “Last Will and Testament of Imam Khomeini” (translated from Farsi), <http://server32.irna.com/occasion/ertehal/english/will/lmnew6.htm> (accessed 19 July 19, 2010).

¹⁴¹ Wehrey et al., *The Rise of the Pasdaran*, 77.

¹⁴² Ali Alfoneh, “The Revolutionary Guards’ Role in Iranian Politics,” *Middle East Quarterly* 15, no. 4 (2008): 3.

¹⁴³ Irano-British Chamber of Commerce. *The Constitution of the Islamic Republic of Iran*.

¹⁴⁴ Alfoneh, “The Revolutionary Guards’ Role in Iranian Politics,” 7.

Rezai from his post.¹⁴⁵ Rezai's replacement, Major General Yahya Safavi, upheld the tradition of directing criticism towards the presidency; taking issue with President Khatami's efforts to implement gradual liberal reform within the government.¹⁴⁶ The latitude of the IRGC vis-à-vis the executive is captured in an open letter to the president written and signed by 24 senior Guardsmen threatening to take action if the "intolerable" student demonstrations of the late 1990s were not suppressed.¹⁴⁷ In both of these cases, there was political friction between the IRGC and the president, but this friction occurred outside of government. Presidents Rafsanjani and Khatami made depoliticization of the military, including the *Pasdaran* and *Basij*, an administrative priority. As a result of these efforts, IRGC representation in the Iranian polity prior to the 2004 Majlis elections was extremely limited.¹⁴⁸

This same degree of antagonism between the military and the executive is not to be found in the relationship between the IRGC and current President Mahmoud Ahmadinejad; neither can it be said that the Guards are still political outsiders. Statements made by IRGC commander Major General Mohammad Ali Jafari in a 2007 speech indicate an evolution of the *Pasdaran* into a praetorian guardianship for the regime. The Iranian paper *Hamshahri* quoted the commander saying, "Our enemy has changed face. We face the threat of a soft overthrow instead of military invasion, so the Guard must also transform accordingly."¹⁴⁹ The allegations of vote-rigging by the IRGC and *Basij* during the 2009 presidential elections accompanied by the brutal suppression of popular dissent following the elections lend credence to the idea that another symbiotic relationship is emerging between the Guards and the government; this time with the presidency.

¹⁴⁵ BBC News "Profile: Mohammad Khatami" *BBC News* June 6, 2010 http://news.bbc.co.uk/2/hi/middle_east/1373476.stm (accessed October 18, 2010).

¹⁴⁶ Alfoneh, "The Revolutionary Guards' Role in Iranian Politics," 8.

¹⁴⁷ Brookings Institute "The Islamic Revolutionary Guard Corps: Military and Political Influence in Today's Iran" http://www.brookings.edu/events/2008/1113_iran.aspx?p=1 (accessed October 18, 2010).

¹⁴⁸ Wehrey et al., *The Rise of the Pasdaran*,

¹⁴⁹ Marc Champion, "World News: Revolutionary Guard Tightens Security Grip --- Intelligence Agency Replaced by New Organization Reporting to Khamenei; Fallout From Massive Street Protests Over Election." *Wall Street Journal*, November 12, 2009: A12.

C. “PRIVATIZATION” OF THE ISLAMIC REPUBLIC

According to the current Iranian Constitution, the economic activity in the Islamic Republic is to be divided between three sectors: public, cooperative, and private. Article 44 defines the scope of state activity as, “*all large-scale and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like.*”¹⁵⁰ The cooperative sector entails, “*production and distribution, in urban and rural areas, in accordance with Islamic criteria.*”¹⁵¹ “*The private sector is the most limited in its definition, focusing on, ‘agriculture, animal husbandry, industry, trade, and services that supplement the economic activities of the state and cooperative sectors.’*”¹⁵² These categorical divisions in the economy and approach to economic development would not survive the three decades of the theocratic government. Today, the Iran has effectively abrogated from Article 44, allowing much greater latitude in terms of foreign participation and private sector activity in the economy.

1. Foreign Outreach

The previous chapter discussed how the late 1980s through the 1990s marked a period of change for Iran, wherein revolutionary zeal gradually gave way to a more pragmatic approach to conducting the business of the state. The system of economic regulations has not been immune to this internal push towards liberalization. Despite the constitutional mandate granting the predominant stake in the Iranian economy to the state sector, privatization in the ownership and management of state-run industries is quickly becoming the new direction for Iranian economic policy. Privatization reform is occurring in concert with government attempts to make Iran more attractive to foreign investment. Passage of the 2002 Foreign Investment Promotion and Protection Act (FIPPA) opened new channels for FDI into Iran by allowing foreign investment in major

¹⁵⁰ Irano-British Chamber of Commerce, *The Constitution of the Islamic Republic of Iran*.

¹⁵¹ Ibid.

¹⁵² Ibid.

infrastructure projects, streamlining investment licensing, further privatizing Iranian banking and financial sector, elimination of nontariff based trade barriers and the establishment of a 25 percent flat tax with exemptions for manufacturing enterprises.¹⁵³ More recently, the Majlis is considering a proposal from Iran's Security and Exchange Organization that would eliminate the practice of blocking foreign invested capital for a three-year period and the increase the limit on shares that can be held by foreigners to 20–25 percent.¹⁵⁴

Luring foreign capital into Iran is an important aspect of Iran's current economic reforms, but it is not the sole concern. Policy makers are also touting a deepening of Iranian integration into the global economy as both another means to bolster the Iranian economy and as a desired end state for the economic reform agenda. One large concrete move towards globalizing the economy is through membership in the World Trade Organization. Iran submitted an application to begin the WTO membership process on 19 July 1996, though currently remains only a third of the way through the process.¹⁵⁵ Economic reforms are typically required prior to joining the WTO and Iran is no exception; Supreme Leader Khamenei attributes the impetus for much of the economic liberalization occurring within to its ongoing bid for WTO membership.¹⁵⁶

Formalization of Iranian economic liberalization began in earnest under Iran's Third Economic, Social, and Cultural Development Plan, expanded under the Fourth Development Plan and continues under legislation introduced by the Special Article 44 Committee of the Majlis and other affiliated legislative organizations.¹⁵⁷ The Third Development Plan called for the establishment of the Iranian Privatization Organization

¹⁵³ Organization for Investment, Economic and Technical Assistance of Iran. "Foreign Investment Promotion and Protection Act." Iranian Privatization Organization, <http://www.en.ipo.ir/index.aspx?siteid=83&pageid=338> (accessed September 26, 2010): 3–4.

¹⁵⁴ Hadfield, "Tehran Opens Door to Foreign Investors," 9.

¹⁵⁵ World Trade Organization, *WTO Accession Status: Iran*, http://www.wto.org/english/thewto_e/acc_e/a1_iran_e.htm. Accessed September 20, 2010.

¹⁵⁶ Middle East Economic Digest. "Supreme Leader Restates Privatisation Plans." *Middle East Economic Digest*. July 7, 2006: 29.

¹⁵⁷ Iranian Privatization Organization. *IPO: Privatization in the 3rd & 4th Economic, Social*. <http://www.en.ipo.ir/index.aspx?siteid=83&pageid=275> (accessed September 20, 2010).

(IPO) under the Ministry of Economic Affairs and Finance. IPO, as the name implies, is the organization responsible for the mechanics for the privatization of select state enterprises; serving as a clearing house for the divestment and sale of governmental company shares to the private and cooperatives sectors of the economy.¹⁵⁸

In 2006, Supreme Leader Khamenei issued an executive order calling for the privatization of 80 percent of all state-owned companies over a ten-year course in order to, “bring about economic development, social justice and the elimination of poverty.”¹⁵⁹ If fully enacted, the sale of state-owned assets will amount to a figure between \$110 and \$120 billion over the ten-year period.¹⁶⁰ The 20 percent of current government holdings set to be retained by the government include the National Iranian Oil Company and all upstream oil production, the primary source of funding for the state’s bloated subsidy system, as well as several key financial institutions, the Central Bank of Iran, Bank Melli of Iran, Sepah Bank of Iran, Bank of Industry and Mines, Bank of Agriculture, Housing Bank (Bank Maskan) and the Export Development Bank of Iran.¹⁶¹

2. The Uncertainty of Sanctions

The history of setbacks in the implementation of the privatization scheme, opacity in book keeping and financial records, and complicated arrangement of formal and informal power sharing in the Iranian Government have deterred the interests of some of the global pool of investors from investing in Iran. The imposition of sanctions has added another layer of uncertainty in Iran’s privatization efforts.¹⁶² The introduction of targeted sanctions against the IRGC and IRGC affiliated companies means that investing in the privatization of profitable state-run company carries a potential for exposure to

¹⁵⁸ “Public Plans and Private Profits.” *MEED: Middle East Economic Digest* 48, no. 1 (January 2, 2004): 32.

¹⁵⁹ Negar Roshanzamir, “Energy Security: Iran to Privatise but Cling to Big Oil Companies,” *Financial Times*, July 3, 2006, <http://www.ft.com/cms/s/0/18c6aece-0ab0-11db-b595-0000779e2340.html> (accessed September 26, 2010).

¹⁶⁰ Hadfield, “Privatization Plan Stalls,” 6.

¹⁶¹ Roshanzamir, “Energy Security.”

¹⁶² “Iran Sanctions Hinder Progress.” *MEED: Middle East Economic Digest* 54, no. 31 (July 30, 2010): 6.

sanctions, effectively dangling the sword of Damocles over the Iranian economy. With the myriad *Pasdaran* front companies (currently estimated at more than 800) and the expansive reach of the IRGC into the Iranian economy, it does not require a large associative leap to expect that this exposure acts as an additional factor to dissuade foreign investment in Iran and its privatization program. Recalling the quote from former-Secretary Paulson at the beginning of this chapter, these words, taken in the context of the 2007 U.S. unilateral and multilateral (via the United Nations Security Council) sanction efforts, could be construed as a veiled threat against foreign investment in Iran. Will Hadfield of the *Middle East Economic Digest* reaches a similar conclusion, anticipating that after the 2007 round of sanctions, “the possibility of Revolutionary Guards being among the local shareholders will probably deter most companies from investing in Iran.”¹⁶³

If the previous argument holds true, then the Iranian government must choose whether or not to limit this negative economic effect by constraining or prohibiting the participation of the IRGC and its affiliates in future privatization efforts. On the other hand, given the current state of affairs within Iran as well as the growing political and economic power of the *Pasdaran*, this choice may be entirely illusory. The rationale behind this assertion is based on the relative independence of the IRGC from the whole of the Iranian government and the dependence of the executives, the Supreme Leader and the president, on IRGC support. The relationship between the current president and the Guards was explored in the previous section on politicization and the relationship between the Supreme Leader and the Guards is explored below.

It is important to note here that the formal power structure of the government does not reflect the directness of the relationship between the Supreme Leader and the IRGC. Indeed, the formal chain of command flows from the Supreme Leader, the constitutionally appointed Commander-in-Chief, through the Supreme National Security Council to the Ministry of Defense and Armed Forces Logistics to the Joint Armed Forces General Staff to the *Pasdaran*. However, the true nature of power sharing in the

¹⁶³ Hadfield, “Privatization Plan Stalls,” 6.

Islamic Republic is seldom, if ever, completely captured through an examination of the formal structure; the case of the IRGC is no exception. The RAND monograph *The Rise of the Pasdaran* dedicates several pages to discussion of how informal power networks “transcend, and in some cases supplant, the official bureaucratic structures-and much of their relative power may reside in their access and proximity to the Supreme Leader.”¹⁶⁴ Taken in consideration with the previous discussion of the tenuous legitimacy of Khamenei, it is fair to characterize the current state of the evolving relationship between the Supreme Leader and the *Pasdaran* as one that is symbiotic in nature, wherein the IRGC augments the authority of Khamenei in exchange for relative autonomy in the conduct of their economic affairs.

Returning to the discussion of why the government would not simply avert the negative effects of IRGC involvement in privatization by prohibiting their participation, it should now be apparent that neither the *IPO*, the *Ministry of Economic Affairs and Finance*, or the *Majlis* have the necessary resources or oversight to prevent the IRGC from participating in the privatization process. The mutual dependency between the IRGC and the Iranian executives (Ayatollah Khamenei and President Ahmadinejad) prevents these institutions from clamping down on *Pasdaran* activity through formal channels. In addition, the diversity and opacity of current IRGC assets effectively prevents an indirect prohibition by screening all of the IRGC affiliate companies from the process. Therefore, as long as profitable state-run companies continue to go to market for privatization, it is almost a certainty that the IRGC will be represented in the pool of potential buyers.

According to the Strategic *Majlis* Research Center, 68.5 percent of privatization sales have gone to the public nonstate sector.¹⁶⁵ As evidence to its interest in privatized companies, the IRGC, through its affiliated bonyads, banks, and investment consortiums, has made several significant purchases. On September 27, 2009, in a transaction branded “noncompetitive” by one *Majlis* MP, the Etemad Mobin Development Company purchased 50 percent plus one of the shares of the Telecommunications Company of Iran

¹⁶⁴ Wehrey et al., *The Rise of the Pasdaran*, 11–13.

¹⁶⁵ Alfoneh “The Revolutionary Guards’ Looting of Iran’s Economy.”

(TCI).¹⁶⁶ Etemad Mobin Development Company is a private consortium is linked to the IRGC. The purchase of the majority stake in TCI was valued at approximately \$7.8 billion and represented the largest trade in the history of the Tehran Stock Exchange.¹⁶⁷ Another sizable sale involved the floating of a 20 per cent stake in the National Iranian Copper Industries Company worth \$1.1 billion.¹⁶⁸ The NICIC sale was placed under parliamentary review after it was alleged in government opposition media that all of the principal buyers involved in the deal maintained a strong association with the Basij militia.

The cumulative effect of this argument is represented in the supply and demand curves in Figure 5 and will be explained further this section. The IRGC, due to its political connections and nebulous nature, is unlikely to be effectively restricted from participating in the Iranian privatization program. Sanctions and, more importantly, the threat of future sanctions, mean that the risk that the IRGC will be represented on the list of shareholders for a newly privatized Iranian company will dissuade many foreign investors from participating in the market. Hence, the pool of potential investors becomes limited primarily to domestic investment. Ali Larijani, current Chairman of the Majlis, pointed out in his criticism of the privatization program that there was not a “genuine private sector” in Iran to absorb these sales.¹⁶⁹ Indeed, cash-strapped private investors in Iran lack the liquidity to generate a demand commensurate with global market competition, D_1 , or the intrinsic value of the companies in the market; this shift in demand is illustrated in the diagram with ΔD .¹⁷⁰ The supply of companies for sale, being

¹⁶⁶ Najmeh Bozorgmehr, “Revolutionary Guards March Roughshod over Private Sector,” *Financial Times*, 5 November 2009, <http://www.ft.com/cms/s/0/3dc0f822-c9ab-11de-a071-00144feabdc0.html#axzz15eyyVbC0> (accessed June 16, 2010).

¹⁶⁷ “NYT Deal Book, 28 September 2009, <http://dealbook.blogs.nytimes.com/2009/09/28/revolutionary-guard-buys-stake-in-iran-telecom/?scp=1&sq=Revolutionary%20Guard%20Buys%20Stake%20in%20Iran%20Telecom&st=cse> (accessed 12 October 2010).

¹⁶⁸ Mohammad Khiabani, “The Great Tehran Expo Privatization Scandal You’ve Never Heard Of,” August 17, 2009, <http://www.pbs.org/wgbh/pages/frontline/tehranbureau/2009/08/the-great-tehran-expo-privatization-scandal-youve-never-heard-of.html> (accessed October 12, 2010).

¹⁶⁹ Alfoneh “The Revolutionary Guards’ Looting of Iran’s Economy.”

¹⁷⁰ Victoria Robson, “Iran Privatization Plan is Flawed,” *MEED*, <http://www.meed.com/sectors/markets/iran-privatisation-plan-is-flawed/752815.article> (accessed October 12, 2010).

dictated by political policy rather than market demand signals, remains fairly inelastic and is illustrated by an almost vertical line, S . The inelasticity of the supply makes the equilibrium price almost an exclusive function of demand. Therefore, a drop in demand, such as the drop triggered by the sanctions regime, will result in a drop in equilibrium price of the privatized companies, ΔP . Cash-rich domestic entities, like the Pasdaran, are then able to purchase shares of the newly privatized companies at the new discounted price, P_2 . Hence, sanctions impose a negative pecuniary externality on the privatization efforts. This externality directly benefits the IRGC by lowering the associated costs of acquiring privatized businesses.

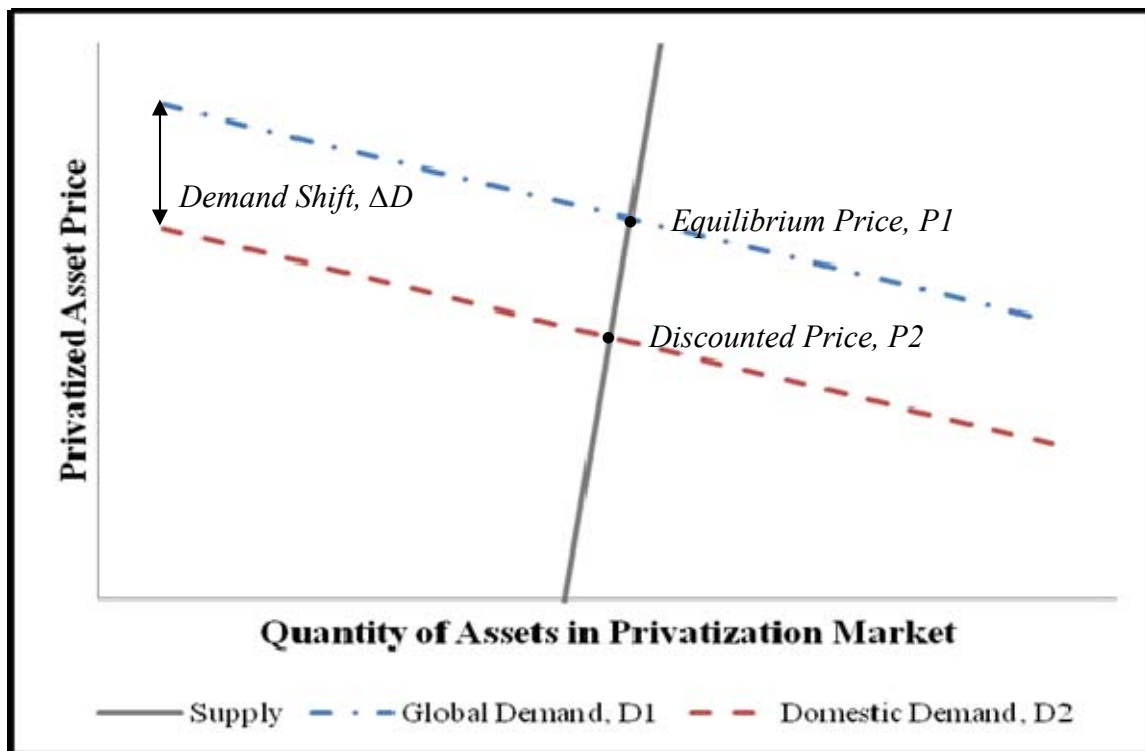


Figure 5. Supply and Demand in Iranian Privatization Markets

3. Financial Estrangement

The previous section introduced the idea that the Iranian economy is currently suffering from a lack of liquidity and foreign currency reserves. The underlying reason for these shortages is largely the result of U.S. unilateral and multilateral sanction efforts.

In 2004, Keba Keinde, the head of corporate finance for the Middle East and North Africa at BNP Paribas in Paris described Iran as, “a land of opportunity for banks.”¹⁷¹ Six years later the “opportunity” represented by Iran and its population of 72 million people does not seem to be so readily apparent to the international finance community. In February of 2010, the U.S. Treasury Department reported that more than 80 foreign financial institutions have terminated or reduced their business with Iran despite not being legally bound to comply with U.S. sanctions.¹⁷² Current U.S. Treasury Secretary Paulson characterizes Iran’s growing isolation from financial markets as being the result of the moral turpitude of the republic:

As awareness of Iran's deceptive behavior has grown, many banks around the world have decided as a matter of prudence and integrity that Iran's business is simply not worth the risk. It is plain and simple: reputable institutions do not want to be the bankers for this dangerous regime. We will continue to work with our international partners to prevent Iran from abusing the international financial system to advance its illicit conduct.¹⁷³

However, this financial flight from the Islamic Republic is more likely due to ongoing pressure from the office of Stuart Levey, current U.S. Under Secretary for Terrorism and Financial Intelligence and architect of much of the contemporary U.S. sanctions policy, than the ethical implications of doing business in Iran.¹⁷⁴ In the calculus of most financial institutions, the potential loss of access to U.S. financial markets outweighs any of the potential benefits offered by doing business inside Iran. The heft behind this threat of exclusion from the U.S. financial market is derived primarily from two instruments, Executive Order 13382 and the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (H.R. 2194).

¹⁷¹ Michael Rothschild, “Iran Lures BNP, HSBC for Loans; U.S. Banks Barred,” Bloomberg, December 23, 2004, <http://www.bloomberg.com/apps/news?pid=21070001&sid=apxPmkzkceWc> (accessed September 17, 2010).

¹⁷² Dubowitz, “The Sanctions on Iran Are Working.”

¹⁷³ U.S. Department of the Treasury, “Statement by Secretary Paulson on Iran Designations.”

¹⁷⁴ U.S. Department of the Treasury, “Treasury Officials: Stuart A. Levey: Under Secretary for Terrorism and Financial Intelligence,” May 29, 2009, <http://www.ustreas.gov/organization/bios/levey-e.html> (accessed October 13, 2010).

a. *Executive Order 13382*

On 28 June 2005, President George W. Bush issued Executive Order 13382. E.O. 13382 drew on two previous WMD related executive orders, E.O. 12938 (1994) and E.O. 13094 (1998), to designate entities as being complicit in WMD proliferation activity. Once designated as a party to WMD proliferation, the Order prohibits all transactions between those designees and any U.S. person and freezes all assets of the designees possess that are subject to U.S. jurisdiction. While E.O. 13382 is aimed at proliferation in general, Iran-related sanctions make up over 140 cases since 2005 and outnumber the combined caseloads of three remaining categories (North Korea, Syria, and the A.Q. Khan network).¹⁷⁵ In addition to the sanctioning the IRGC, itself, as well as Ghorb and several of its subsidiaries the Furthermore, this Executive Order authorized the Departments of States and Treasury to designate additional WMD proliferators and supporters, expediting the sanctioning process and the threat that doing business in Iran could represent.

b. *Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (H.R. 2194)*

H.R. 2194 further expanded the Iran Sanctions Act (ISA), the current version of the Iran-Libya Sanctions Act of 1996 that removed Libya from the law in 2003 following rapprochement with the United States. H.R. 2194 includes several key components with respect to the Iranian financial market. First, Title I expands the ledger of secondary sanctions from six to nine; adding a prohibition on access to foreign exchange in the United States, a prohibition on access to the U.S. banking system, and a prohibition on property transactions in the United States. Second, Title I also directs the Secretary of the Treasury to prohibit U.S. banks from opening or maintaining correspondent accounts for any foreign financial institutions facilitating transactions for the IRGC. The same measures apply to any Iranian financial institutions designated as supporting the acquisition of weapons of mass destruction or supporting of terrorism

¹⁷⁵ A complete list of designated entities can be found on the U.S. Treasury Department website: <http://www.state.gov/t/isn/c22080.htm>.

under the International Emergency Economic Powers Act (IEEPA).¹⁷⁶ Third, Title II allows state and local government as well as private asset management entities to divest from businesses conducting operations in the Iranian energy sector.

D. CONCLUSION

This period of time was witness to a renewed government effort to reduce the size of the public sector through the selling assets to the private and cooperative sectors. Supreme Leader Khamenei defined the ambitiousness of the privatization effort in a 2006 executive order that called for privatizing 80 percent of the government's economic holdings. In an effort to maximize the potential returns from the privatization process, Iran turned to courting foreign investors. To make Iran more attractive to foreign capital the Majlis introduced measures that restructured the framework regulating foreign ownership, including the landmark Foreign Investment Promotion and Protection Act of 2002.

The study of sanctions on Iran following the 2005 presidential election can be characterized by the fourth hypothesis, *sanctions increase risk exposure that inhibits foreign competition*. The new smart sanctions regime changed the dynamics of previous iterations by introducing a *credible* (i.e., frequently applied, extraterritorial threat against any foreign firm doing business in Iran). Sanction violators faced a wide range of penalties including separation from U.S. financial and commercial markets. Inhibiting foreign competition is particularly beneficial to the IRGC given the ongoing changes to the character of the Iranian economy. Reducing the amount of capital and investment flowing into Iran gives the relatively cash-rich IRGC a much better position to participate in the Iranian privatization market.

¹⁷⁶ U.S. House of Representatives Committee on Foreign Affairs "Summary of H.R. 2194, the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010" http://www.hcfa.house.gov/111/press_062410a.pdf (accessed October 15, 2010).

V. SUMMARY, IMPLICATIONS, AND EXPANSION

A. SUMMARY

This thesis has endeavored to show how sanctions have played a role in the continuing militarization of Iran. In presenting its case, this thesis has incorporated several significant factors from the myriad that have shaped economic and political decisions in both Iran and the United States. The inclusion of narrative context along with the body of sanctions was intended to develop the idea that the militarization of Iran and the mutable regime of U.S. sanctions maintain a complicated, but well-established, relationship. In fairness to the analysis, this relationship cannot be stripped away from its context and distilled in order to satisfy the definitions for the comparative conditions of necessity and sufficiency. The economic, political, and social conditions within Iran are unique and should be treated accordingly. Within Iran, however, the effects of these sanctions can be generalized into three basic categories, referred to in this summary as “gaps.”

1. The Defense Gap

The student-led takeover of the American Embassy in Tehran and subsequent hostage crisis severed the already chilly relations between Ayatollah Khomeini and the Carter administration. In response the United States froze all Iranian assets subject to U.S. control and brought all finance and commerce between the two states to an abrupt end. Among the various sectors affected by the Carter era sanctions, few experienced greater impact than the Iranian defense industry. The main Iranian defense conglomerate, Military Industries Organization, was built largely through its multiple partnerships with firms in the American defense industry. A look at the Iranian order of battle for the 1970s and 1980s reflects this dependency on American military hardware. The United States essentially lifted its sanctions regime after President Carter lost his 1981 reelection bid for the White House and Ayatollah Khomeini released the American hostages. Diplomatic relations between Iran and the United States, however, remained strained.

President Reagan upheld *prima facie* the previous administration's policy of keeping U.S. weapons and weapon technology out of the Islamic Republic. The need for war materiel inside Iran became amplified by the outbreak of a war with neighboring Iraq. The United States eventually sided with Iraq and established a formal arms embargo against Iran. Operation Staunch widened the gap in the supply of weapons systems and crucial spare parts that had begun with the exodus of American defense firms following Executive Order 12205.

The defense gap exacerbated the Islamic Republic's materiel disadvantage against its opponent Iraq, but benefitted the IRGC in two ways. First, because the *Pasdaran* occupied a prominent position (in terms of battlefield presence and leadership) towards the end of the Iran-Iraq War, they were in a prime position to shoulder public disappointment over the outcome of the war. The deficiency in materiel brought about by an embargo from the "Great Satan" gave Ayatollah Khomeini an alternative target to deflect criticism. Second, despite the loss of Iran's main defense supply chain, Iranian defense expenditure soared to new heights over the course of the war. A substantial portion of this expenditure went into the development of a more broadly capable domestic defense industry. At the end of the war the IRGC's relationship with the new Defense Industries Organization gave the Guards access to construction equipment and industrial manufacturing capacity at a time when the general economy of Iran was in tatters.

2. The Foreign Goods and Services Gap

The post-war period in Iran was host to important changes within the theocracy. The populism that gave rise to Ayatollah Khomeini and the Guardianship of the Islamic Jurists was replaced by a more pragmatic system of clientelism under Ayatollah Khamenei. Presidents Rafsanjani and Khatami both embarked on a program to promote the cautious introduction of liberal reform in the Islamic Republic. Among the various reforms enacted under Rafsanjani was an initiative to curb public spending and balance the Iranian budget. The government was able to trim expenditure, in part, through the

institution of a new policy that freed government organizations to generate their own streams of revenue. One of the outcomes of this new policy was the establishment of the *Pasdaran* engineering conglomerate, Ghorb.

Prior to the Iran-Libya Sanctions Act of 1996, U.S. sanction efforts directed abroad were focused on keeping the flow of weapons and weapon technology out of Iran. ILSA changed the paradigm, expanding the reach of sanctions to include foreign companies (to Iran and the United States) investing in the underperforming Iranian energy sector. Ghorb would continue to grow throughout the 1990s aided by the absence of U.S. competition and reduced foreign competition. Ghorb revenues would explode in the latter half of the following decade as the United States, made wary by Iranian nuclear ambitions, ratcheted efforts to dissuade foreign firms from developing the Iranian energy sector. The exodus of foreign companies from 2007 to the present created a void for the politically connected IRGC to exploit to the tune of billions of dollars in state contracts.

Additionally, E.O. 12938, 12959, and 13059 criminalized exporting all American-made goods and many foreign-made “dual-use” goods to Iran. In response, the flow of most of these sanctioned goods simply shifted from commercial shipping to transnational smuggling channels. The IRGC benefits from this shift as it is widely accepted that the organization is intimately involved with most of the smuggling activity occurring within Iran. Revenues derived from the last two decades of smuggling have combined with revenues from “legitimate” commercial activity to ensure the coffers of the IRGC’s financial network are flush with capital.

3. The Finance Gap

A decade after ILSA opened the door to extraterritorial sanctions, the scope of the U.S. sanction efforts expanded again; this time to include Iranian access to foreign finance. Diplomatic demarches, Executive Order 13322, The Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2009, and the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 attempt to constrain Iranian access to foreign capital flows as a means to deter further development of the Iranian nuclear weapons program and punish the state’s ongoing human rights abuse. This thesis

proposes that such capital constraints are beneficial to the IRGC as it limits the pool of investors participating in Iran's ongoing efforts to privatize 80 percent of its massive public sector.

Targeted sanctions add an additional layer of uncertainty to investing in Iran that dissuades foreign investors from direct investment in Iran or supplying capital to cash-strapped Iranian investors. Targeted sanctions against the IRGC and its affiliates and secondary sanctions against foreign firms investing in IRGC affiliates significantly reduce the appeal of investing in any company with the potential for IRGC shareholder representation. While the Iranian government has enacted several measures over the last decade to lure foreign investment, the IRGC commands sufficient political power and economic resources to prevent its exclusion from the privatization process. Furthermore, the IRGC, due to its revenue streams from its licit economic activities and black market profits, possesses greater liquidity than other domestic actors. Therefore, the *Pasdaran* is likely to be well represented in current and future sales of profitable and undervalued public firms. As the role of the *Pasdaran* in privatization sales expands, the role of foreign investment and foreign financed domestic investment decreases, this reduces competition and equilibrium prices alike. Hence, with the influence of sanctions in effect, the more the IRGC participates in the Tehran Stock Exchange, the better the bargain they receive.

B. IMPLICATIONS

One of the implications of this thesis is that it creates an apparent contradiction in U.S. foreign policy. As the previous chapters have shown, a principle desired end state underlying all of U.S.-Iranian sanctions since the middle of the 1990s has been Iran's abandonment of its nuclear program. The IRGC is accepted by the United States and the IAEA as the primary agency responsible for the development of the nuclear program. To confront Iran's nuclear intransigence the United States has opted for a policy of targeted sanctions against entities affiliated with the IRGC. These sanctions were implemented to serve as a deterrent for the organization and encourage the *Pasdaran* to discontinue its role in the alleged nuclear weapons program. However, the position of this thesis is that

sanctions have supported the growth of *Pasdaran* economic and political power. It is reasonable to assume that the senior leadership within the IRGC would welcome greater success in penetrating the Iranian economy. Hence, with the current sanctions in place there is little immediate incentive for the IRGC to abandon the nuclear program.

Sanctions, including both general and targeted, have worked to varying degrees to keep Iran isolated from the global economy. However, the *Pasdaran*, due to the mafia-like nature of their economic network, are generally positioned to benefit more from a closed domestic economy than from an open globalized economy.¹⁷⁷ Stuart Levey, U.S. Treasury Under Secretary for Terrorism and Financial Intelligence, confirms that sanctions are expanding the role of the IRGC in the Iranian economy in his own assessment of “conduct-based” sanctions.¹⁷⁸ The Under Secretary’s remarks then attempt to reconcile the seemingly beneficial nature of sanctions with their underlying intent with the claim that a larger IRGC presence makes levying follow-on smart sanctions against the IRGC more effective and easier to implement.¹⁷⁹ Perhaps, given a sufficiently long period, the successive rounds of sanctions approach could work; anticipating that 1) *IRGC economic expansion*, 2) *Treasury Department recognition of new IRGC expansion*, and 3) *Crafting and implementation of appropriately targeted sanctions* to be serial steps in the process with each step requiring a certain period of time in order to properly take effect. However, time vis-à-vis Iranian nuclear development is not a luxury that the United States possesses.

The 2007 National Intelligence Estimate on the Iranian nuclear program prognosticates with moderate certainty that Iran, “would be technically capable of producing enough HEU for a weapon sometime during the 2010–2015 time frame.”¹⁸⁰

¹⁷⁷ For description of mafia-like network see: CFR interview with Karim Sadjapour “Sadjapour: Revolutionary Guards Have Financial Interests in Keeping Iran Isolated” and Babak Dehghanpisheh, “Smugglers for the State.”

¹⁷⁸ U.S. Department of the Treasury, “Treasury Under Secretary for Terrorism and Financial Intelligence Stuart Levey Remarks at the Center for Strategic and International Studies Washington, D.C.” (Press Release TG-862), September 20, 2010, <http://www.ustreas.gov/press/releases/tg862.htm> (accessed October 12, 2010).

¹⁷⁹ U.S. Department of the Treasury, “Treasury Under Secretary.”

¹⁸⁰ National Intelligence Council, “Iran: Nuclear Intentions and Capabilities,” 2007, http://www.dni.gov/press_releases/20071203_release.pdf (accessed October 19, 2010).

As mentioned in the previous chapter, in early 2010, Iran announced that its nuclear program had breached the 20 percent threshold and produced highly enriched uranium, HEU.¹⁸¹ This “highly enriched” classification represents more than an exercise in semantics, at 20 percent enrichment the uranium could theoretically be weaponized in a fission device; though, practical weapon considerations (i.e., size and weight of the weapon) necessitate an enrichment level of greater than 80 percent.¹⁸² Additionally, continuing the enrichment process to produce weapons-grade uranium reveals a second distinction between high and low enriched uranium. The process to enrich from 20 percent to 80 percent is faster and technically easier to accomplish than reaching 20 percent enrichment starting at uranium’s naturally occurring state of 0.7 percent. Given these considerations, it is realistic to conclude that the window of opportunity to deter the Iranian nuclear program through a slow-acting sanctions regime has closed.

The other implication arising from this study of Iran is not nearly as bleak as confronting the inevitability of a nuclear-armed Iran. On the contrary, the militarization of Iran may offer some potential benefits for the United States. The primary benefit comes from splitting the economic and political interests of the senior leadership of the organization. In other words, the entrenchment of *Pasdaran* economic interests and the manifestation of *Pasdaran* political influence could dissuade Iran from future conflict with the United States. As the *Wall Street Journal* claims, “A few IRGC commanders, including some at the top, do not relish a conflict with the U.S. that could destroy their business empires...there is no guarantee that, in case of a major war, all parts of the IRGC would show the same degree of commitment to the system.”¹⁸³

¹⁸¹ At 20 percent (and greater) concentrations of isotope U-235, uranium receives the distinction of being referred to as highly enriched uranium.

¹⁸² NPR, “A Chemistry Lesson on Uranium,” <http://www.npr.org/templates/story/story.php?storyId=126890142> (accessed October 26, 2010).

¹⁸³ Taheri, Amir. “Who Are Iran's Revolutionary Guards?” *Wall Street Journal*, November 15, 2007: A25.

C. EXPANSION

Time and transparency have constrained the quantity and quality of the information utilized in the construction of this thesis. If the future allows scholars to scrutinize past machinations of the government and the Guards in greater resolution, this thesis leaves considerable room for later confirmation, expansion, or refutation; the major points of that are discussed below.

1. Transparency

In terms of transparency, as mentioned in the introduction the factious circles of formal and informal power within the Islamic Republic of Iran have made information a tightly-controlled commodity. The free flow of information out of Iran is further restricted by the antagonistic relationship between Iran and the United States and the effect that relationship produces on the generation of objective and informative media coverage on Iran. Hence, several arguments advanced in this thesis could benefit from greater transparency and diligent investigation. First, a time series of the value of IRGC assets, holdings, interests would be invaluable to supporting or refuting this thesis. Second, explicit accounting of Iranian defense expenditure throughout the Iran-Iraq War period, focusing on the value of MIO/DIO assets at the beginning and ending of the war, would provide much greater resolution to the arguments introduced in Chapter II.

2. Time

In terms of time, the writing of this thesis is proximate to the implementation of a new series of sanctions against Iran. Although the author does not anticipate a dramatic departure from the *Pasdaran* response to previous sanction efforts (in that the IRGC will leverage its considerable economic and political resources to adapt and prosper), it is far too early to speculate or reach an understanding of the implications and effects of these new sanctions. Hence, a thorough analysis of the effects of the recent series of “smart” sanctions remains open as a topic for future study.

3. International Sanctions

An additional opportunity for expansion of this thesis is incorporation of the international body of sanctions into the analysis. The limits placed in this thesis would not allow for thoughtful consideration of additional sanctions regimes beyond that imposed by the United States. This exclusion does not greatly impact the study of U.S. sanctions given the predominant position of the United States in the global trade network and the fact that U.S. sanctions reflect and generally expand on sanctions imposed by United Nations Security Council Resolutions. However, exploring the implementation and ramifications of UNSCR 1696, 1737, 1747, 1803, and 1929 on Iran's principle trading partners might yield additional information useful for a more complete assessment of the effects of Iranian sanctions with respect to the militarization of Iran.

APPENDIX OF SANCTIONS

| Date | Sanction | Author | Key Points |
|-------------|---|----------------------------|---|
| 14-Nov-79 | E.O. 12170 | Carter | Blocked all property and interests of property of the Government of Iran, its instrumentalities and controlled entities and the Central Bank of Iran that are or become subject to the jurisdiction of the United States |
| | F.R. 50841 (1982), 44741 (1984), 45901 (1985), 41067 (1986), 43549 (1987), 45750 (1988), 46043 (1989), 47453 (1990), 57791 (1991), 48719 (1992), 58639 (1993), 54785 (1994), 55651 (1995), 56107 (1996), 51591 (1997) | Reagan, Bush (41), Clinton | Continuation of E.O. 12170 |
| 7-Apr-80 | E.O. 12205 | Carter | <p>Prohibited any person subject to U.S. jurisdiction from the sale, supply, or transfer of any items outside of humanitarian aid (medical supplies, food, etc.) to any entity associated with Iran</p> <p>Prohibited shipment by U.S. affiliated transport of items for any entity associated with Iran</p> <p>Prohibited shipment of items for any entity associated with Iran from the United States by Iranian affiliated transport</p> <p>Prohibited extending new credit or loans; providing new depository instruments; advancing favorable terms; or allowing transfer of funds, property, or interests (outside of family remittances) to any entity associated with Iran</p> <p>Prohibited any person subject to U.S. jurisdiction from engaging in new service contracts for Iranian industrial projects</p> |
| 17-Apr-80 | E.O. 12211 | Carter | Added the ban on allowing transfer of funds, property, or interests (outside of family remittances) to any entity associated with Iran to E.O. 12205 |

| | | | |
|-----------|---------------------------|--------|---|
| | E.O. 12211 (continued) | | <p>Prohibited import of Iranian goods or services to the United States other than materials for news publication</p> <p>Prohibited any transactions by U.S. citizens or permanent residents with foreign entity or persons for travel to Iran</p> <p>Prohibited payment of any expenses within Iran for any U.S. citizen or permanent resident other than for news-gathering purposes</p> <p>Authorized the Secretary of the Treasury to revoke licenses for transactions with Iran Air, National Iranian Oil Company, and National Iranian Gas Company and restrict use of U.S. passports for travel to, in, through Iran</p> <p>Delegated Presidential powers from Emergency Economic Powers Act, Immigration and Nationality Act, Revised Statutes, Act of July 3, 1926, National Emergencies Act, and International Emergency Economic Powers Act to the Secretary of the Treasury pursuant to carrying out the Order</p> |
| 23-Jan-81 | E.O. 12276 | Carter | Authorized the Secretary of the Treasury to transfer Iranian assets frozen under E.O. 12170 to an escrow account managed by the Central Bank of Algeria in order to ensure the release of 52 U.S. diplomats and nationals being held hostage in Iran |
| 23-Jan-81 | E.O. 12277 | Carter | Directed the transfer of Iranian gold bullion and similar assets from the Federal Reserve Bank of New York to the Bank of England for transfer to Iran |
| 23-Jan-81 | E.O. 12278 | Carter | Directed the application of commercial interest backdated to 14 November 1979 and transfer of Iranian financial assets from all U.S. banks to the Federal Reserve Bank of New York Account at the Bank of England or to the original banking institution |

| | | | |
|-----------|------------|---------|---|
| 23-Jan-81 | E.O. 12280 | Carter | Directs the transfer of Iranian financial assets from all U.S. nonbanking institutions to the Federal Reserve Bank of New York Account at the Bank of England |
| 23-Jan-81 | E.O. 12281 | Carter | Directs the transfer of Iranian property, not including funds and securities, to authorized Iranian agents |
| 23-Jan-81 | E.O. 12282 | Carter | Revoked all prohibitions contained in E.O. 12205 and 12211 and Proclamation 4702 (which blocked the import of Iranian oil into the United States) |
| 23-Jan-81 | E.O. 12283 | Carter | Released the Government of Iran from any indemnity sought in response to losses sustained by any person subject to U.S. jurisdiction as a result of the hostage crisis or Iranian Revolution |
| 23-Jan-81 | E.O. 12284 | Carter | Restricted transfer of property belonging to the estate of or close family connection to Mohammad Reza Pahlavi, former Shah of Iran, pending termination of estate litigation |
| 30-Oct-87 | E.O. 12613 | Reagan | Restricted the import of all goods and services of Iranian origin to the United States, its territories and possessions, except news materials and petroleum products refined in a third country |
| 14-Nov-94 | E.O. 12938 | Clinton | Prohibited the export of any goods, technology, or services subject to the Secretary of Commerce's export jurisdiction that would assist a foreign country in acquiring the capability to develop, produce, stockpile, deliver, or use weapons of mass destruction or their means of delivery. Charged the Secretary of State to pursue negotiations with foreign governments to adopt similar measures. |

| | | | |
|-----------|---------------------------|--------------|---|
| | E.O. 12938 (continued) | | <p>Prohibited government procurement of goods and services from individuals who knowingly and materially contributed to the efforts of any foreign country, project, or entity to use, develop, produce, stockpile, or otherwise acquire chemical or biological weapons</p> <p>For state violators the Order eliminated any foreign assistance channeled through the state agencies, engendered U.S. opposition to multilateral development bank loans, cut U.S.-backed credit and financial assistance, prohibited the sale of arms and export of National-Security Sensitive Goods and Technology, imposed import and export restrictions, and denied landing rights for carrier-based aircraft</p> |
| 15-Mar-95 | E.O. 12957 | Clinton | Prohibited the entry into or performance by a United States person, or the approval by a United States person of the entry into or performance by an entity owned or controlled by a United States person, of (i) a contract that includes overall supervision and management responsibility for the development of petroleum resources located in Iran, or (ii) a guaranty of another person's performance under such a contract |
| | E.O. 12957 | | Prohibited the entry into or performance by a United States person, or the approval by a United States person of the entry into or performance by an entity owned or controlled by a United States person, of (i) a contract for the financing of the development of petroleum resources located in Iran, or (ii) a guaranty of another person's performance under such a contract |
| 6-May-95 | E.O. 12959 | Bill Clinton | Prohibited the importation into the United States, or the financing of such importation, of any goods or services of Iranian origin |

| | | | |
|-----------|---------------------------|-----------|---|
| | E.O. 12959 (continued) | | <p>Prohibited the re-exportation to Iran, the Government of Iran, or to any entity owned or controlled by the Government of Iran, of any goods or technology (including technical data or other information) exported from the United States, the exportation of which to Iran is subject to export license application requirements under any United States regulations</p> <p>Prohibited any transaction, including purchase, sale, transportation, swap, financing, or brokering transactions, by a United States person relating to goods or services of Iranian origin or owned or controlled by the Government of Iran</p> <p>Prohibited any new investment by a United States person in Iran or in property (including entities) owned or controlled by the Government of Iran</p> |
| 19-Aug-97 | E.O. 13059 | Clinton | Consolidated and clarified the prohibitions specified in E.O. 12957 and E.O. 12959 |
| 28-Jun-05 | E.O. 13382 | Bush (43) | Augmented E.O. 12938 with respect to the proliferation of WMD and the means of delivering them by blocking the property of specially designated WMD proliferators and members of their support networks and denying those parties access to the U.S. financial and commercial systems |

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